Attachment A

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities	:	
	:	
Proposed General Increase in Gas Rates	:	Docket No. 14-0371

COMPANY DRAFT ORDER

I. INTRODUCTION

A. Procedural History

On March 31, 2014, Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities ("Liberty Midstates" or the "Company") filed with the Illinois Commerce Commission ("Commission"), pursuant to Section 9-201 of the Public Utilities Act (the "Act") (220 ILCS 5/9-201), the following second revised tariff sheets: ILL C.C. No. 1 sheets No. 3, 5, and 7. This tariff filing embodied a proposed general increase in gas rates. The tariff filing was accompanied by direct testimony, other exhibits, and other materials required by 83 Ill. Adm. Code Parts 285 and 286.

The Company posted notice of the proposed tariff changes reflected in these filings in Liberty Midstates' business offices and published notice twice in secular newspapers of general circulation in the Company's service area, in accordance with the requirements of Section 9-201(a) of the Act and the provisions of 83 Ill. Adm. Code Part 255.

On May 7, 2014, the Commission entered a Suspension Order, suspending the proposed tariffs to and including August 27, 2014. The Commission entered an Amendatory Order on May 13, 2014 which made a correction to the Company's name and the date of filing. On July 30, 2014, the Commission issued a Resuspension Order that suspended these tariffs to and including February 27, 2015.

In response to a May 1, 2014 deficiency letter, the Company provided additional information on May 13 and May 28. Status hearings were held in this matter before a duly authorized Administrative Law Judge of the Commission at its offices in Springfield, Illinois on May 28, 2014 and October 9, 2014. No petitions to intervene were filed. An evidentiary hearing was held on October 16, 2014. Counsel for Liberty Midstates and for Staff witnesses entered appearances and exhibits filed by these parties were admitted into evidence.

Liberty Midstates and Staff each filed an Initial Brief and Reply Brief. A proposed Order was served on the parties on [December 24, 2014]. [Liberty Midstates and Staff each filed a Brief on Exceptions and a Reply Brief on Exceptions.] The Briefs on Exceptions and Reply Briefs on Exceptions have been considered in the preparation of this Order.

B. Nature of Operations

Liberty Midstates is a Missouri corporation engaged in the distribution of natural gas in Illinois, Iowa, and Missouri.[1] Liberty Midstates began operations in August 2012 following the Commission approval of the acquisition of Atmos Energy Corporation's natural gas distribution assets in Docket 11-0559.[2] The Company serves approximately 22,000 customers in Illinois.[3]

C. Test Year

The Company proposed to use a future test year consisting of the twelve months ending December 31, 2015.[4] Staff did not object to the use of this test year. The Commission concludes that the future test year Liberty Midstates proposes is acceptable for the purposes of this proceeding.

D. Legal Standard

Section 9-101 of Act requires that "[a]ll rates or other charges made, demanded or received by any product or commodity furnished or to be furnished or for any service rendered or to be rendered shall be just and reasonable." Conversely, "[e]very unjust or unreasonable charge" or rate are "prohibited and declared unlawful." Ratepayers are also not required to pay for costs unless those costs can be shown to "directly benefit them or the services" which the utility renders. Illinois Bell Tel. Co. v. Illinois Commerce Comm., 55 Ill. 2d 461, 482 - 483 (1973). Section 9-201 (c) of the Act provides in part that the "burden of proof to establish the justness and reasonableness of the proposed rates or other charges . . . shall be on the utility."[5]

II. <u>RATE BASE</u>

A. Uncontested Issues

1. Interest Synchronization Calculation

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[1] Company Ex. 1.0 at 2:41-3:49.
[2] *Id.*
[3] *Id.*
[4] Company Ex. 1.0 at 6:121-124.
[5] 220 ILCS 9-201(c).

Staff witness Knepler proposed an adjustment for interest synchronization to ensure that the revenue requirement reflects the tax savings generated by the interest component of the revenue requirement.[6] Staff witness Knepler calculated the interest expense component by multiplying rate base by the weighted cost of debt.[7] The calculated interest expense is then compared to the Company's test year income tax expense. The Company agreed that this methodology is appropriate but disputed the inputs used by Staff.[8] Specifically, the Company objected to (1) the imputed capital structure used by Staff to calculate the weighted cost of debt[9] and (2) the state income tax rate.[10] The Company and Staff both agreed that the interest synchronization calculation should incorporate the capital structure and state income tax rate approved by the Commission.[11]

The Commission finds that the methodology proposed by Staff and agreed to by the Company is reasonable and is adopted in this proceeding. The Commission further agrees that the calculation of interest synchronization set forth in the appendices to this Order shall reflect the state income tax rate approved in Section V.B.1 and the capital structure approved in Section VI.B.1 of this Order.

2. Budget Payment Plans

The Company's initial Part 285 filing used a different time period than the required December 2014 through 2015 period to calculate the 13-month average of the account balances for the test year.[12] The Company submitted corrected balances in response to the ALJ's deficiency letter. Staff witness Ostrander proposes an adjustment to rate base of ($26,692) to reflect the Company's corrected 13-month average of account balances of amount of ($3,878).[13] The Company agreed with Staff's proposed adjustment.[14]

The Commission finds that Staff's adjustment to rate base as agreed to by the Company is appropriate and is adopted.

3. Utility Plant – Meters

The Company inadvertently omitted $403,769 of gross plant related to meters in its rate base.[15] Mr. Krygier testified that the meters were placed in service in 2013 and

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[6] Staff Ex. 1.0 at 6:104-114.
[7] *Id.*
[8] Company Ex. 8.0 at 9:187-10:195.
[9] Company Ex. 7.0 Revised at 24:456-461.
[10] Company Ex. 6.0 at 1:20-8:167.
[11] Staff Ex. 6.0 at 13:272-14:280; Company Ex. 8.0 at 9:187-10:195.
[12] Schedule B-14; Staff Ex. 2.0 at 11:235-12:240.
[13] Staff Ex. 2.0 at 11:223-12:240; Staff Schedule 2.03.
[14] Company Ex. 5.0 at 11:240-12:246.
[15] *Id*. at 18:381-392.

for the test year, the amounts related to these meters totaled $377,971 of net plant and total test year accumulated depreciation of $25,797.[16] The Company stated that the meters were necessary to ensure safe and reliable service to Liberty Midstates' customers.[17]

Staff witness Ostrander agreed that the meters should be added to rate base.[18] Mr. Ostrander additionally proposed an adjustment to Accumulated Deferred Income Taxes ("ADIT") to reflect the addition of the meters.[19]

The evidence in the record demonstrates that the omitted meters were placed into service in 2013 and are necessary for the safe and reliable distribution of gas to customers. Accordingly, the Commission finds that the proposed amounts in respect of meters should be included in rate base.

4. Accumulated Deferred Income Taxes

Staff witness Ostrander proposed an adjustment to ADIT to reflect an average net plant balance, a state income tax rate of 7.75%, and corrected allocation factor of 28.47% for shared plant allocations.[20] During rebuttal, Mr. Ostrander presented additional adjustments to (1) increase ADIT for the inclusion of the meters omitted from the Company's initial filing and (2) decrease ADIT to reflect Staff's proposed disallowance of capitalized incentive compensation.[21]

The Company disputed several of the inputs relied on by Staff witness Ostrander. Specifically, the Company objected to Staff witness Ostrander's use of an average net plant balance, state income tax rate, and his proposed disallowance of capitalized incentive compensation.

Having considered the evidence, the Commission finds that Staff's methodology of calculating ADIT, as agreed to by the Company, is appropriate and adopts it. As with other issues on which the parties agree regarding the calculation methodology but disagree regarding certain inputs to that methodology, the Commission's adoption of the methodology is subject to the changes to the inputs discussed subsequently in this Order.

5. Original Cost Determination

Staff witness Ostrander stated that data request responses provided by the Company support the plant additions since the last rate case.[22] Mr. Ostrander

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[16] *Id.*
[17] *Id.*
[18] Staff Ex. 7.0 at 10:190-11:199.
[19] *Id*.
[20] Staff Ex. 2.0 at 8:174-9:183; Staff Schedule 2.02.
[21] Staff Ex. 7.0 at 7:121-137; Staff Schedule 7.02.
[22] Staff Ex. 7.0 at 14:282-15:285.

recommends that the Commission make a finding in this proceeding that the amount of $52,686,071, as of December 31, 2013, be approved for purposes of an original cost determination.[23]

The Commission finds that the $52,686,071 original cost for plant at December 31, 2013 is unconditionally approved as the original cost of plant.

6. Cash Working Capital

The Company and Staff agreed that the formula method is an appropriate method to calculate cash working capital in this proceeding.[24] The formula method provides a simplified method of determining cash working capital needs based upon the assumption that a utility requires 45-days or 1/8 of a year to collect cash outlays for the provision of service to its customers.[25]

Staff witness Knepler proposed an adjustment to remove uncollectible expense because it is a non-cash expense, and therefore, does not require a working capital allowance.[26] The Company noted that removing uncollectible expense from the cash working capital calculation is not always appropriate but did not object to its removal in this proceeding.[27]

Although the Company and Staff agree on the methodology for calculating cash working capital, they disagree on the inputs for operating expenses. The parties recommend that the final balance of cash working capital be determined by the level of operating expenses determined to be just and reasonable by the Commission.[28] This includes the uncollectible expense adjustment as well as other adjustments to operating expenses discussed later in this order.

Having considered the evidence, the Commission finds that the formula method is an appropriate way to calculate the balance of cash working capital in this proceeding. The Commission adopts Staff's recommendation, which was not objected to by the Company, to remove uncollectible expense from cash working capital. The Commission agrees that it is appropriate to determine cash working capital using the level of operating expenses and the level of uncollectible expenses approved in this order.

B. Contested Issues

1. Average Rate Base

a. Company's Position

[23] *Id*. at 15:286-300.
[24] Staff Ex. 1.0 at 13:260-14:274; Company Ex. 6.0 at 10:214-218.
[25] Staff Ex. 1.0 at 13:260-14:274.
[26] Staff Ex. 1.0 at 13:260-14:274.
[27] Company Ex. 6.0 at 10:222-226.
[28] Staff Ex. 6.0 at 11:225-229; Company Ex. 6.0 at 10:214-218

In determining the rate base in this proceeding, the Commission must decide whether to use the rate base total at the end of the test year, or the "average rate base," which in this case, uses the rate base projected to exist at the mid-year point of the test year. The Company's proposed rate increase is based on the year-end rate base.[29] Staff witness Ostrander proposed an adjustment to use the mid-year rate base. The Company objected to Staff witness Ostrander's proposed adjustment.[30]

The Company acknowledged that the Commission has frequently used average rate base instead of year-end rate base in cases involving future test years.[31] However, the Company pointed out that in doing so the Commission has indicated that it does not require the use of average rate base in such proceedings.[32] The Company noted that most of the cases cited by Staff witness Ostrander were uncontested with regard to this issue. The Company argued that it is aware of only three dockets in which this issue was actually contested: Central Illinois Public Service Company's ("*CIPS*") 1990 rate case (Docket 90-0072)[33]; Nicor's 2004 rate case (Docket 04-0779)[34]; and People's Gas 2012 rate case, (Docket 12-0512).[35] The Company argues that the Commission made it clear that although it was adopting an average rate base approach, the determination of whether to use an average rate base or a year-end rate base is based on the facts and circumstances in each individual case—as the Commission described it, a "close issue."[36] The Company states that the Commission made it clear that the Commission has not adopted a general rule requiring one approach or the other.[37] The Company asserts that the Commission has based its findings on the facts and circumstances of the particular case.[38] In this case, the Company argues that the particular facts of this proceeding justify the adoption of a year-end rate base.[39]

The Company stated that this proceeding is taking place during a period of significant increasing plant in service.[40] The Company noted that it is at the beginning of a vigorous infrastructure improvement program that will last well beyond 2015. The Company stated that there is a strong likelihood the rates adopted in this proceeding will

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[29] Company Ex. 6.0 at 11:228-241; Schedule B-1.
[30] Staff Ex. 2.0 at 3:37-47; Staff Schedule 2.01; Staff Schedule 7.01.
[31] Company Initial Brief at II.B.1
[32] Company Ex. 6.0 a 15:333-346.
[33] Cent. Ill. Public Service Co., Docket No. 90-0072, 1990 Ill. PUC LEXIS 625 (Order, Nov. 28, 1990). [hereinafter CIPS 1990]
[34] Northern Ill. Gas Co. Docket No. 04-0779 (Order, Sept. 20, 2005). [hereinafter Nicor 2004]
[35] Peoples Gas Light and Coke Co., Docket No. 12-0512(Cons) (Order, June 18, 2013). [hereinafter PGL 2012].
[36] CIPS at 6; *See* PGL 2012 at 38 (finding average rate base is more appropriate based on the facts and circumstances this proceeding).
[37] *See* Nicor 2004 at 7 (noting that previous precedent has not established a general rule).
[38] *See* PGL 2012 at 38 (finding average rate base is more appropriate based on the facts and circumstances of this proceeding); Nicor 2004 at 8 (finding that the facts in this case do not support a year-end rate base).
[39] Company Initial Brief at II.B.1.
[40] Company Ex. 6.0 at 16:347-357.

remain in effect for a number of years.[41] The Company noted that the average rate base proposed by Staff witness Ostrander would only exist in June 2015, less than five months after the rates set in this docket are expected to become effective.[42]The Company stated that the use of average rate base in a situation such as this, where rate base is substantially increasing over time, will understate rate base for nearly all of the time that rates are in effect.[43] The Company states this is contrary to Mr. Ostrander's mistaken assertion that a year-end rate base is not more representative of the rate base that will exist when the proposed rates will be in effect.[44] The Company argued that the average rate base suggested by Mr. Ostrander would exist only in June 2015, four months after the rates set in this docket are expected to become effective.[45]

The Company stated that it is undisputed that it has been underearning since its inception.[46] The Company asserts this fact mitigates concerns that might otherwise be associated with the using year-end rate base.[47] The Company stated that it will be significantly underearning until approximately early March 2015 when the rates set in this proceeding are expected to go into effect.[48] The Company asserts the use of an average plant net balance for the test year will exacerbate the effects of this underearning because after only a few months the Company's rate base will be greater than that on which its newly adopted rates are based.[49] The Company states that the Commission can moderate the effects of this underearning by using the year-end rate base to set rates.[50]

Liberty Midstates noted that the Company is in a different position than that of other utilities in cases where the Commission has implemented an average rate base.[51] The Company states that the utilities in dockets highlighted by Staff witness Ostrander have been in operation for over a hundred years, were not filing their first rate case, and had not been underearning for such long period of time between rate case filings as the Company.[52] Liberty Midstates asserted that its operating and financial situations are drastically different from these larger utilities.[53] The Company noted that its projects are not large enough for it to access the capital markets each time it initiates a project, nor is it constantly accessing the capital markets such as larger utilities may do with shelf registrations.[54] Liberty Midstates asserted that it must aggregate its capital needs and

[41] Company Ex. 9. at 7:156:8-159.
[42] Company Ex. 9.0 at 8:159-166.
[43] *Id.*
[44] Staff Ex. 2.0 at 4:72-5-74.
[45] Company Ex. 9.0 at 8:159-166.
[46] Company Ex. 6.0 at 16:358-17:364.
[47] *Id.*
[48] *Id.*
[49] *Id.*
[50] *Id.*
[51] *Id.* at 17:365-372; *See* CIPS 1990 at 6-7; Nicor 2004 at 7-9; PGL 2012 at 38.
[52] Company Ex. 6.0 at 17:365-372.
[53] *Id*.
[54] *Id*. at 17:373-382.

obtain funding in advance for plant.[55] The Company states that investors require return from the money they invest, which in Liberty Midstates' case will predate the date on which the plant in service is entered on the books.[56] The Company notes that while this issue exists for Liberty Midstates in any case, using average net plant exacerbates the problem more than using end of year balances.[57]

The Company disagrees with Staff witness Ostrander's assertion that in future test years an average net plant balance is appropriate because during a time of more frequent rate cases, utilities tend to invest more.[58] Company witness Long stated that in his more than thirty-five years of experience, utilities do not seek funds and then establish what investment can be made with those funds.[59] Rather, utilities establish the necessary investment plan and seek funds to pay for that plan.[60] As a result, the Company states the only way the Company can be fairly compensated for investments it will make during 2015 is for rates established for that period to include all investment made during that period.[61]

The Company also disagrees with Staff's claim that an average rate base is appropriate because the future test year itself is forward looking.[62] The Company states that using an average plant balance would actually bring the future period back six months assuming investment is made evenly throughout the year.[63] Liberty Midstates argues this would place rate-base-related costs out of synch time-wise with the income statement costs used in the revenue requirement.[64] The Company states that it will have expended monies for a full twelve months of investment and operating expense, but the rates would only include compensation for one half of that investment.[65]

The Company argued that adopting a measurement of net plant that is expected to be exceeded within five months after the rates in this case go effect does not allow Liberty Midstates to recoup its full costs of providing service.[66] The Company asserts that it will have already made arrangements for the necessary capital to add net plant throughout 2015—it will already be paying investors returns on that plant and therefore needs to recoup those costs.[67] The Company states that it will be severely underearning in the first two months of 2015.[68] Liberty Midstates argued that its net plant in service is expected to exceed Staff's proposed average rate base calculation four short months

[55] *Id.*
[56] *Id.*
[57] *Id.*
[58] Company Ex. 9.0 at 7:136-150.
[59] *Id.*
[60] *Id.*
[61] *Id.*
[62] Company Ex. 6:120-135.
[63] *Id.*
[64] *Id.*
[65] *Id.*
[66] Company Initial Brief at II.B.1.
[67] *Id.*
[68] *Id.*

thereafter.[69] Liberty Midstates asserted that adopting the year-end net plant reflects the actual investment being made during the test year, more properly matches the period's operating expense and income to the Company's investment, and allows the Company to recoup its costs of providing service.[70]

b. Staff's Position

[Insert]

c. Commission Analysis and Conclusion

The Commission has reviewed the evidence in the record and its past decisions on this issue. As the Commission has previously stated, the issue of whether to use an average rate base or a year-end rate base is a close call. The Commission finds that a year-end rate base calculation is more appropriate based on the facts of this particular case. We note that Liberty Midstates is a relatively small utility that cannot raise funds for capital expenditures on a project-by-project basis and does not access the capital markets frequently, but must raise funds to cover capital projects considerably in advance of putting plant into service. We also note that Liberty Midstates is in the initial phases of a significant infrastructure improvement program which is expected to continue for some time and that capital expenditures are expected to increase through the test year and in the years following. Based on the specific facts before us, the selection of an average rate base would compromise Liberty Midstates' ability to recover its costs of service. Therefore we find that the use of the year-end rate base is the appropriate response for this case.

2. Accumulated Deferred Income Taxes

As previously described in Section II.A.4, the methodology for calculating ADIT is not contested, but several of the inputs are subject to the contested adjustments discussed in Sections II.B.1, II.B.3, and III.B.1.b. The Commission's conclusions are reflected in the appendices.

3. Incentive Compensation

Staff witness Ostrander proposed adjustments to disallow (1) $8,033 of capital related to the Long Term Incentive Plan ("LTIP"); $16,585 of capital related to the Short Term Incentive Plan ("STIP") and the Shared Bonus Pool Program ("SBPP").[71] Under the discussion of operating expenses, Staff witness Ostrander recommends corresponding disallowances for the operating expense portion of the LTIP, STIP and SBPP.[72] In light of the Commission's conclusion on this issue in Section III.B.3, the

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[69] *Id.*
[70] *Id.*
[71] Staff Schedule 7.03.
[72] *Id.*

Commission also finds that the capital portion of Staff's adjustment should be rejected. The rationale for this finding is the same as discussed in Section III.B.3.

III. OPERATING EXPENSES

A. Resolved Issues

1. Property Taxes - Test Year

Staff witness Knepler proposed three adjustments with respect to property taxes: (1) the removal of a duplicative inflation increase; (2) an adjustment of $6,311 related to a correction of the application of an inflation factor; and (3) the removal of a projected amount related to the Company's office building that is in the process of being constructed in Vandalia.[73] Staff's total adjustment to property taxes equals ($73,484).[74] The Company stated that it views the adjustments somewhat differently but in an effort to keep matters simple accepted each of Staff's adjustments.[75]

The Commission having reviewed the evidence finds that Staff's adjustment is appropriate and is adopted.

2. Outside Professional Services

The Company requested $452,712 for the recovery of outside professional fees in its initial filing.[76] On rebuttal, the Company stated that it underestimated that amount and presented a corrected amount of $544,266 based upon 2013 actual expenses ($538,266) and a 3% inflation factor.[77]

Staff witness Knepler recommended that the Commission not include in operating expenses payments made to the Company's predecessor for transition and training services to assist Liberty Midstates in its new ownership and management roles of the Company.[78] Staff witness Knepler testified that if Liberty Midstates' request to establish a Service Company in Docket 14-0269 is approved, it is likely some economies of scale will be achieved which have not been considered in this proceeding.[79] The total of Staff's proposed adjustment to outside services equals ($206,194). The Company did not object to Staff's proposed adjustment.[80]

Staff additionally proposed that the Company report semi-annually to the Manager of Accounting of the Commission its progress in complying with a plan

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[73] Staff Ex. 1.0 at 9:169-10:202.
[74] Staff Schedule 1.11.
[75] Company Ex. 6.0 at 8:179-185.
[76] Schedule C-4.
[77] Company Ex. 5.0 at 5:102-109; Company Ex. 5.06.
[78] Staff Ex. 6.0 at 10:190-201.
[79] *Id*.
[80] Company Ex. 8.0 at 6:122-7:132.

proposed by the Company in Company Exhibit 8.0 to identify and distinguish: (1) Liberty charges that are (a) direct charged to the Illinois jurisdiction, and (b) allocated to the Illinois jurisdiction and (2) other affiliate charges that are (a) direct charged to the Illinois jurisdiction and (b) allocated to the Illinois jurisdiction.[81] Staff stated that the report should be titled, Status Report of Progress in Implementing Accounting Controls and Procedures to Enable Reporting of Costs charged to Liberty Midstates/Illinois from Affiliates.[82] Staff requested that the first report should be filed by October 1, 2015 and subsequent reports should be filed at six-month intervals until the accounting controls and procedures are effectively implemented.[83] Liberty Midstates agreed to provide this report.[84]

The Commission having considered the evidence in the record, finds that Staff's adjustment is reasonable and is adopted. The Commission additionally finds that Staff's proposed semi-annual report on the progress of the accounting plan as agreed to by the Company is appropriate and is adopted.

3. Rate Case Expense

Section 9-229 of the Act provides that, "[t]he Commission shall specifically assess the justness and reasonableness of any amount expended by a public utility to compensate attorneys or technical experts to prepare or litigate a general rate case filing. This issue shall be expressly addressed in the Commission final order."

In its initial filing, the Company estimated rate case expense in the amount of $707,500.[85] The Company proposed to amortize rate case expense over a three year period.[86] Staff did not object to using a three year period to amortize rate case expense.[87] During rebuttal testimony, the Company revised its rate case expense estimate to $865,478 for an increase of $157,978. The Company stated that it was necessary to revise its estimate based on its understanding of outstanding issues and actual expenses incurred.[88] The Company also noted that initially made a very conservative estimate of rate case expense.[89] Staff stated that the Company has supported the proposed increase to its rate case expense through supplementary response to Staff data requests.[90] The Company presented supporting documentation in the form of all rate case related data request responses in Company Exhibit 8.03. This supporting documentation included engagement letters, qualifications of rate case consultants, and invoices of actual expenses incurred.

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[81] Staff Cross Ex. 1.
[82] *Id.*
[83] *Id.*
[84] *Id.*
[85] Schedule C-10.
[86] Staff Ex. 7.0 at 14:275-280.
[87] Staff Ex. 7.0 at 14:275-280.
[88] Company Ex. 5.0 at 13:271-14:291.
[89] *Id.*
[90] Staff Ex. 7.0 at 11:214-12:221.

The estimate of $865,478 additionally incorporates two adjustments to rate case expense proposed by Staff.[91] Staff proposed to remove the remaining estimated expenses for ADIT consultant, Mr. Bourrassa because the Company anticipated that Mr. Bourrassa's work was materially complete.[92] Staff additionally proposed the recovery of the actual costs of the initial Part 285 consultant, Mr. Schmidt whose costs were not included in the Company initial rate case expense estimate.[93]

Staff witness Ostrander stated that he has reviewed the invoices provided to him by the Company and his opinion the amounts appear to be reasonable.[94] Staff witness Ostrander additionally reviewed the documentation provided by the Company that supports the remaining estimated rate case expense not yet invoiced and stated that it appears the amounts are just and reasonable.[95] Mr. Ostrander proposed that the Commission find that:

> "The Commission has considered the costs expended to compensate attorneys and technical experts to prepare and litigate this rate case proceeding and assesses that such costs in the total of amount of $856,478, which is $288,493 amortized over 3 years, are just and reasonable pursuant to Section 9-229 of the Act (220 ILCS 5/9-229)."

The Commission having considered the record, finds that Staff's proposed finding is just and reasonable and is adopted. In making this assessment, the Commission observes that the Company has provided ample and credible support for its rate case expense estimate. The work performed for Liberty Midstates by the attorneys and technical experts was reasonably necessary to prepare and litigate this proceeding. Many of the ratemaking issues in this proceeding were complex and were addressed by the parties through their respective expert witnesses. Such issues and areas included among others, cost of capital, cost of service and rate design, operating expenses, and rate base. The evidentiary record contains over 150 pages of invoices, contracts, narrative discovery responses, and schedules that were provided in support of Liberty Midstates' rate case expense.

4. Allocation from Shared Services (LABS)

Staff witness Knepler initially proposed a disallowance for allocations for shared services (LABS) because it believed Liberty Midstates did not have an affiliate agreement with (LABS).[96] On rebuttal, the Company clarified that what it calls Shared Services (LABS) is provided pursuant to a Commission-approved affiliate agreement

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[91] Company Ex. 5.0 at 12:265-13:268.
[92] Staff Ex. 2.0 at 12:244-250.
[93] *Id*.
[94] Staff Ex. 7.0 at 13:241-247.
[95] *Id*.
[96] Staff Ex. 2.0 at 12:244-250

with Liberty Utilities (Canada) Corp. (also called LUC).[97] The Company explained that LABS is a business group within LUC and not a separate legal entity.[98] The Company additionally stated that the costs related to the shared services LABS group that is part of LUC are test year expenses that are necessary in providing services to Liberty Midstates customers and should be included in rates.[99] Following the Company's explanation, Staff withdrew its proposed adjustment to allocations from shared services.[100]

Upon review of the evidence and in light of Staff's withdrawal of its adjustment, the Commission finds that no adjustment is necessary to allocations from shared services.

5. Depreciation Expense

Staff proposed an adjustment to depreciation expense to correct the depreciation rate for Account 365.1 Land Right of Ways. Staff states that the correct depreciation rate is zero, since land is not depreciable.[101] This adjustment results in a reduction of test year depreciation expense of $879.[102] The Company accepted Staff's proposed adjustment.[103]

The Commission finds that Staff's proposed adjustment is just and reasonable and is adopted.

B. Contested issues

1. Gross Revenue Conversion Factor

Staff and the Company agree on the method for calculating the Gross Revenue Conversion Factor ("GRCF"), but disagree on the inputs. The parties dispute the appropriate level of uncollectible expense and the state income tax rate. The Commission's determination on these two issued are discussed below and the conclusions are reflected in the GRCF calculation in the appendices to this Order.

a. Uncollectible Expense Rate

i. Company's Position

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[97] Company Ex. 5.0 at 10:209-218.
[98] *Id.*
[99] *Id.*
[100] Staff Ex. 6.0 at 11:216-221
[101] Staff Ex. 2.0 at 14:286-291.
[102] Staff Schedule 2.05.
[103] Company Ex. 5.0 at 14:303-306.

In determining its revenue requirement, the Company used an uncollectible expense rate of 0.70%.[104] The Company identified this rate as its best estimate of the likely uncollectible expense rate to be in effect in the test year. Staff witness Knepler, however, proposed the use of a five-year historical average of uncollectible expense from 2009 through 2013 (combining reports from the Company and from the Company's predecessor) resulting in an uncollectible expense rate of 0.51%. The Company disagreed with Staff's proposed adjustment.[105]

The Company stated that its own recent experience indicates a higher level of uncollectibles than suggested by Staff.[106] The Company noted that its actual uncollectible rate in 2013 was 1.03%.[107] The Company also stated that it is reasonable to expect an increase in uncollectible expense in the test year due the impact of the first rate increase in this service area in over fourteen years.[108] The Company stated that based on these factors the uncollectible expense ratio of 0.70% is reasonable.[109] The Company criticized Staff's approach for failing to take into consideration these factors that are likely to affect test year uncollectibles.[110] The Company's proposal takes into account that the Company's believes that it will be able to improve collections over time relative to its prior year's experience.[111]

In support of its estimate, the Company presented a calculation of a three-year average rate of uncollectibles to address Staff's concerns regarding year-to-year fluctuations.[112] The uncollectible rate using a three-year average is 0.68%, that the Company states is consistent with and supports its proposed rate of 0.70%.[113] The Company notes the three-year average indicates the Company's proposal is reasonable and not unduly affected by a single year's fluctuations.[114]

The Company expressed concern regarding the data underlying Staff's five-year average.[115] The Company stated that the more recent data used by the Company is a better indicator of the level of uncollectible expense that would be expected to occur in the test year -- the data used by Staff reaches back to 2009.[116] The Company asserts that this data is too outdated to present a reliable picture of uncollectible expenses in 2015.[117] Liberty Midstates also objected to the use of data from a different company, its

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[104] Schedule C-16.
[105] Company Ex. 9.0 3:57-6:112.
[106] Company Ex. 5.0 at 4:67-76.
[107] *Id.*
[108] *Id.*
[109] *Id.*
[110] Company Ex 5.0 at 4:81-5:88.
[111] Company Ex. 8.0 at 4:84-87.
[112] Company Ex. 5.0 at 4:77-87.
[113] *Id.*
[114] *Id.*
[115] Company Ex. 5.0 at 3:52-64.
[116] *Id.*
[117] *Id.*

predecessor. [118] The Company questioned the accuracy of that data, and in particular noted that at least some of the data used cannot be accurate. For instance, the data for 2010 indicates a negative uncollectible amount.[119] The Company points out that there is nothing in the record to explain how such a negative amount could arise, that Staff did not explain this anomaly, and that the Company has not been able to verify any of the non-Company data used by Staff in its five-year average.[120]

Staff additionally presented an average rate of uncollectibles based on a four-year average of 2010 through 2013 and additionally an average rate with high and low years removed.[121] The Company stated that its objection to the questionable data continues to apply to Staff's four-year average calculation. The Company also pointed out that the exclusion of the high year in Staff's calculation inappropriately excludes the most recent data from 2013, which is actually the most relevant and most reliable figure.[122] The Company asserted that Staff's approach results in a calculation that is too far removed from the 2015 test year to present a reliable indication of the level of uncollectible expense that will be incurred in the test year.[123] The Company also noted that the high and low year exclusion method would only rely on five months of operations by Liberty Midstates itself.[124] All of the other data is from a different company and may be derived using different methodologies.[125]

Staff testified that the Commission had used a five-year average in certain other cases. However, the Company pointed out that all but one of the cases testified to by Staff did not involve future test years.[126] The Company also stated that in none of the cases testified to by Staff did the Commission use data from companies other than the utility seeking a rate increase. The Company noted that the Commission has previously found that the methodology used in cases using a historical test year is not determinative in rate cases using a future test year.[127] The Company argued that the Commission has examined the facts and circumstances of a particular rate case to determine the reasonableness of an uncollectible expense estimate, rather than mandating a particular methodology be used.[128] Based on the facts in this proceeding, including historical data, the Company stated its proposal of 0.70% represents the best estimate of uncollectible expense that will occur in the test year.[129] The Company states

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[118] *Id.*
[119] *Id.*
[120] *See* Company Ex. at 8.0 3:65-4:70.
[121] *See* Staff Ex. 6.0 at 7:124-135; Staff Schedule 6.08.
[122] Company Ex. 8.0 at 4:73-80.
[123] *Id.*
[124] *Id.*
[125] *Id.*
[126] Company Ex. 8.0 at 5:93-107.
[127] *Id; See* Northern Ill. Gas Co., Docket 08-0363 at 30 (Order, March 25, 2009) ("Because the recent Ameren Illinois rate cases did not involve use of a future test year, what was done in that Docket, Docket 07-0585, is not determinative.").
[128] Company Ex. 8.0 at 5:93-107.
[129] *Id.*

Staff's approach ignores the data reliability issues raised by the Company and the likely challenges that will be faced in the test year.[130]

ii. Staff's Position

[Insert]

iii. Commission's Conclusion and Analysis

Having reviewed the evidence in the record, the Commission finds that the Company's uncollectible expense rate of 0.70% is supported and is adopted. The Commission agrees that no particular methodology is appropriate in all rate cases. A 0.70% uncollectible expense rate is supported by testimony indicating it is the most likely uncollectible expense for the test year. It is very close to the three-year average which indicates that the amount is insulated from unreasonable year-to-year fluctuation. In addition, this estimate takes into account the Company's actual, recent experience, rather than the questionable data included in Staff witness Knepler's five-year average. Staff did not state that its approach took into account the likely effect of a rate increase in the test year on uncollectibles. Accordingly, the Commission believes that the record supports the Company's use of a 0.70% uncollectible expense rate.

b. State Income Tax Rate

i. Company's Position

The Illinois corporate income tax rate in place when the Company prepared and initiated the filing of its rate case was 9.5%[131] and this rate represents what the Company believes is the most likely corporate income tax rate to be in effect in 2015.[132] Staff objected to the use of the 9.5% state income tax rate because the state income tax rate is scheduled to reduce to 7.75% absent legislative action on January 1, 2015.[133]

The Company disagreed with Staff's proposed adjustment and noted that the absence of legislation extending the 9.5% state income tax rate during the testimony phase of this proceeding is not indicative of the rate of taxes that will be in effect in 2015.[134] Liberty Midstates noted that the most likely time for the state income tax

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[130] *Id*.
[131] The 9.5% rate consists of a 7% state corporate income tax and a 2.5% personal property replacement tax. For simplicity purposes, these two taxes are combined and referred to as the 9.5% state income tax rate.
[132] Company Ex. 6.0 at 2:39-42.
[133] The 7.75% rate consists of a 5.25% state corporate income tax and a 2.5% personal property replacement tax. For simplicity purposes, these two taxes are combined and referred to as the 7.75% state income tax rate.

[134] Company Ex. 6.0 at 3:61-4:79.

extension to be addressed by the General Assembly is after the November election, and probably even after the start of 2015.[135]

The Company stressed that it is not seeking to game the state income tax rate.[136] The Company stated that if evidence becomes available that demonstrates it is more likely that the current corporate income tax rate will be changed (lower or higher for that matter) for 2015, a change to the proposed rates would be warranted.[137] However, the because Commission may be required to make a determination regarding which tax rate is more likely to be in effect in 2015 the Company presented evidence showing that the most likely tax rate will be 9.5%.

Based on the evidence available at the time of the Company's Initial Brief, the Company stated it believes it is very unlikely the state corporate income tax will be 7.75% in 2015.[138] The Company noted that based on the state's financial condition and statements made by the current governor and state legislators, it is highly likely the current state corporate income tax rate of 9.5% will remain in place beyond January 1, 2015. Liberty Midstates noted that Speaker of the House Madigan, and Senate President Cullerton (with their intact veto-proof majorities in the general assembly) support extending the 9.5% corporate income tax rate.[139]

The Company argued that Illinois has the lowest credit rating of all fifty states and without additional revenues faces severe budget shortfalls.[140] The Company presented a Moody's Sector Comment for Illinois dated June 5, 2014, that indicated if legislators do not reverse or offset the scheduled tax reduction in some fashion, Illinois' backlog of payments to vendors, municipalities, public universities, and other entities will triple to $16.2 billion in the next three years.[141] The Company likewise noted that Governor Quinn's FY 2015 Budget Address noted that "[if action is not taken to stabilize our revenue code . . . extreme and radical cuts will be imposed on education and critical public services."[142] The Company argued that even with a new governor taking over later in 2015, these budgetary pressures remain as strong as ever.[143]

The Company additionally presented evidence of statements made by Governor Quinn, Senate President Cullerton, Speaker of the House Madigan, and Senator Kirk Dillard (R-Hinsdale) on the State's need for revenue and the likelihood that tax rates will need to be addressed in the near future.[144] In addition to the general acknowledgement by legislators and the governor that income tax revenues must remain, Company

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[135] *Id.*
[136] Company Ex. 6.0 at 5:93-99.
[137] *Id.*
[138] Company Ex. 6.0 at 5:109-8:167.
[139] *Id.*
[140] *Id.*
[141] *Id;* Company Ex. 6.1.
[142] Company Ex. 6.0 at 5:109-8:167; Company Ex. 6.2.
[143] Company Initial Brief at III.B.1.b.
[144] Company Ex. 6.0 at 5:109-8:167; Company Ex. 6.3-6.5.

witness Long stated that he is not aware of any credible proposals by leading politicians that would allow for a reduced corporate income tax rate.[145] Mr. Long noted that while there is some support for reducing *individual* income tax levels in 2015, he is not aware of evidence indicating strong support specifically for the reduction of state *corporate* income tax rates. Mr. Long additionally stated that he does not know a single person who believes this state would ever reduce taxes being collected.[146]

The Company noted that the Commission has previously used for ratemaking purposes a state tax rate that had not yet been adopted based on the likelihood of the extension of the tax.[147] To the extent that the tax rate for 2015 is not definitively known, the Company states that the Commission must review the available evidence to determine the most likely income tax rate that will apply in the test year. The Company submits that, absent a conclusive legal action, the record evidence can only support the conclusion that the most likely corporate income tax rate for 2015 is 9.5%.

ii. Staff's Position

[Insert]

iii. Commission's Conclusion and Analysis

[Alternate 1]

Based on the General Assembly's action to extend the state income tax rate of 9.5%, the Commission finds that a rate of 9.5% state income tax is appropriate in this proceeding.

[Alternate 2]

Having reviewed the evidence in the record, the Commission agrees with the Company that the 9.5% state income tax rate is the most likely rate to occur during the test year.

2. Incentive Compensation

a. Company's Position

Staff proposes disallowing approximately: (1) $18,682 of costs related to the LTIP, consisting of $10,649 of expenses and $8,033 of capital; (2) $38,530 of costs related to the STIP and SBPP consisting of $21,962 of expenses and $16,568 of capital.[148] The Company disagrees with Staff's proposed adjustment.

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[145] Company Ex. 6.0 at 5:109-8:167.
[146] Company Ex. 9.0 at 2:44-3:46.
[147] *See* Iowa-Illinois Gas and Electric Co., Docket 92-0357 (Cons.), 1993 Ill. PUC LEXIS 245, *67 (Order, July 21, 1993)(approving expired surtax on the likelihood of its continuance).
[148] Staff Ex. 5.0, Schedule 5.01.

The Company argues that the Commission should reject Staff's proposed adjustment for three reasons.[149] First, the Company stated that incentive compensation is a cost that was incurred in the test year and will be incurred going forward.[150] Second, the Company stated that incentive compensation is an important recruiting and retention tool.[151] The Company stated that Staff did not dispute these two benefits. Third, the Company stated that financial incentives are important metric which ultimately benefit customers.[152]

The Company notes that Staff does not dispute that incentive compensation costs will be incurred in the test year or that incentive compensation can be useful recruiting tool.[153] The Company disagreed with Staff that basing incentive compensation on financial metrics benefit does not benefit customers. [154] The Company pointed out that financial metrics provide benefits by encouraging more efficient operations, the benefits of which ultimately flow to customers.[155] The Company states that efficiency is encouraged because the Company's financial metrics are not only impacted by revenues, but costs as well.[156] Liberty Midstates additionally asserts that ratepayers directly benefit from the cost controls incentivized by the Company's financial metrics.[157] Finally, the Company states that customers benefit from the financial health and stability of the utility and encouraging workers to enhance that stability should be encouraged.[158]

The Company additionally argues that the incentive compensation packaged offered by the Company to its employees should be viewed as an overall package that has financial performance as one of many goals.[159] The Company states that the packages, as a whole, benefit customers by encouraging employees to reach higher levels of on-the-job performance overall.[160] Liberty Midstates also notes that segregating and disallowing particular portions of the incentive packages miss the point that these plans are set up to have significant benefits for all stakeholders of the Company.[161]

b. Staff's Position

[Insert]

c. Commission's Conclusion and Analysis

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[149] Company Ex. 5.0 at 5:317-323.
[150] *Id.*
[151] *Id.*
[152] *Id.*
[153] Staff Ex. 7.0 at 9:176-177; Company Ex. 8.0 at 9:173-175.
[154] Company Ex. 8.0 at 9:179-185.
[155] Company Ex. 5.0 at 16:351-357.
[156] *Id*.
[157] *Id*.
[158] *Id.*
[159] Company Ex. 5.0 at 17:358-365.
[160] *Id.*
[161] *Id.*

Having reviewed the evidence, the Commission finds that the incentive compensation projected to be paid in the test year are appropriate payroll expenses that are necessary for the Company to provide service. Accordingly, no adjustment to the Company's expense for incentive compensation is appropriate.

IV. RATE OF RETURN

A. Resolved Issues

1. Short-Term Debt Ratio

Staff proposed that the Company's capital structure contain 0.46% short-term debt.[162] Staff calculated the short-term debt ratio by measuring the average net short-term outstanding for the Company for the twelve months ending June, 2014.[163] To narrow the issues in this proceeding, the Company accepted Staff's recommended short-term debt ratio.[164]

The Commission finds that the undisputed short-term debt ratio agreed to by the Company and Staff is reasonable and consistent with the act, and therefore approves it.

2. Cost of Short-Term Debt

Staff estimated the cost of short-term debt equal to 1.41.%[165] Staff estimated the cost of short-term debt by starting with the average one-month LIBOR rate for the 30 days ending January 31, 2014, which equals 0.162%.[166] Staff then added 1.25% to the one-month LIBOR rate to derive the Company's cost of short-term debt.[167] The Company accepted Staff's proposed cost of short-term debt.[168]

The Commission finds that the undisputed cost of short-term debt agreed to by the Company and Staff is reasonable and consistent with the Act, and therefore approves it.

3. Embedded Cost of Long-Term Debt

The Company and Staff agreed on a long-term debt cost of 4.81%.[169]

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[162] *See* Staff Schedule 8.01.
[163] Staff Ex. 3.0 at 6:110-7:113.
[164] Company Ex. 10.0 at 4:75-81.
[165] Staff Ex. 3.0 at 9:152-158.
[166] *Id.*
[167] *Id*.
[168] Company Ex. 10.0 at 4:75-81.
[169] *See* id; Staff Ex. 8.0 at 2:19-25; Staff Schedule 8.03.

The Commission finds that the undisputed cost of long-term debt agreed to by the Company and Staff is reasonable and consistent with the Act, and therefore approves it.

B. Contested Issues

1. Common Equity and Long-Term Debt Ratios

a. Company's Position

i. Actual Capital Structure

The Company recommends that its actual capital structure be adopted and Staff's proposed imputed capital structure be rejected. Liberty Midstates noted that the Commission has previously taken the position that "a hypothetical capital structure should only be used when the utility's actual capital structure is found to be unreasonable, imprudent or unduly affected by such circumstances as double leverage as so to unfairly burden the utility's customers."[170] Liberty Midstates' actual capital structure consists of 60.10 percent equity ratio and 39.90 percent long-term debt.[171]

The Company presented the testimony of expert witness Robert Hevert on issues relating to capital structure and cost of equity.[172] Mr. Hevert noted that one reasonable means of assessing the Company's capital structure is to consider the observable and relevant benchmarks such as the capital structures in place at the proxy companies (used by both Mr. Hevert and Ms. Phipps in determining cost of equity), or that of Liberty Midstates ultimate parent company, APUC. Mr. Hevert testified that Liberty Midstates' 60.10 percent equity ratio is within the range of equity ratios, of the companies that make up the proxy group that both Mr. Hevert and Staff witness Rochelle Phipps use to evaluate the Company's cost of equity.[173] In addition, Mr. Hevert pointed out that Liberty Midstates' actual capital structure is generally consistent with the 56.64 percent average equity ratio of APUC (which is the ultimate source of both Liberty Utilities Co. ("LUCo") and Liberty Midstates' equity, and influences the credit rating of the debt that finances their operations) over the past eight fiscal quarters.[174] The Company noted that the Commission has previously compared the equity ratio of a utility to its ultimate parent in Docket 11-0281 when reviewing the reasonable of a capital structure.[175]

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[170] Ill. Bell Tel. Co. v. Ill. Commerce Comm'n, 283 Ill. App. 3d 188, 205 (2d Dist. 1996) (citing People ex. rel. Hartigan III, 214 Ill. App. 3d 222, 228 (1991)); *See* Cent. Ill. Light Co., Docket 06-0070 at 102 (Order, Nov. 21, 2006) (noting that starting point is typically testimony and data from the utility's tariff filing, which typically reflects an actual capital structure").
[171] Schedule D-1 (Second Deficiency Response)
[172] *See* Company Ex. 4.0; Company Ex. 7.0 Revised; Company Ex. 10.0.
[173] Company Ex. 7.0 Revised at 12:207-216.
[174] Company Ex. 7.0 Revised at 12:207-216.
[175] *See* Peoples Gas Light and Coke Co., Docket 11-0281 at 108 (Order, Jan 10, 2012).

The Company emphasized that equity ratio is an important factor in a company's overall risk profile and has a strong influence on its credit rating and, therefore, cost of capital.[176] Mr. Hevert testified that as the equity ratio decreases, the degree of financial leverage and, therefore, financial risk increases.[177] In Mr. Hevert's expert opinion, in recommending a relatively low equity ratio, Staff is asking the Company to adopt a degree of financial leverage that is far removed from industry practice, and which exposes Liberty Midstates to additional risk.[178]

Mr. Hevert stated that utilities face both business and financial risk.[179] With regard to financial risk, increasing financial leverage increases the risk that a company may not have adequate cash flow to meet its financial obligations.[180] Mr. Hevert stated that all else remaining equal, a meaningful increase in financial leverage is likely to lead to a higher cost of both debt and equity.[181] Mr. Hevert testified that because APUC's and LUC's credit ratings already are below the proxy group's average credit rating, Ms. Phipps' proposal would only further increase the Company's financial risk.[182] Mr. Hevert further noted that to the extent Liberty Midstates faces incremental business risks associated with its relatively small size, regulatory environment and exposure to weather variability, it would be reasonable for it to finance its operations with an equity ratio above the average equity ratio of the proxy group companies, not substantially below, as Ms. Phipps suggests.[183] Further, the Company noted that the Commission has previously found that "[i]f the levels [of equity and debt] are not set properly, the Company may experience negative market consequences. A severe error may result in rates that are not just inappropriate, but confiscatory."[184]

The Company pointed out that Staff witness Phipps stated that she chose to impute a capital structure because she did not have confidence in the Company's capital structure data.[185] The Company disagreed with Staff's assertion that its capital structure data was not reliable.[186] The Company took issue with the fact that Ms. Phipps considered certain updates by the Company to include information it previously omitted from a filing to mean that its capital structure data unreliable.[187] For example, the Company did not include retained earnings in Schedule D-1 of its initial filing, but included it in them in its revised filing. Ms. Phipps did not allege that the retained earnings figures were unreliable-- they simply were inadvertently not included on a schedule.[188] Following the submission of corrective responses, the Company pointed

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[176] Company Ex. 7.0 Revised at 11:188-190.
[177] *Id.* at 11:190-192.
[178] Id. at 11:191-193.
[179] *Id. at 11:194-195.*
[180] *Id*. at 11:95-197.
[181] *Id. at 11:197-198.*
[182] *Id. at 11:198-201.*
[183] *Id*. at 22:201-12:205.
[184] Commonwealth Edison. Co., Docket 05-0597 at 57 (Order on Rehearing, Dec. 20, 2006).
[185] *See* Staff Ex. 3.0 at 3:56-57.
[186] Company Ex. 8.0 at 10:206-11:218.
[187] *Id*.
[188] *Id.*

out that Ms. Phipps did not identify any area where she remained uncertain regarding the Company's capital structure. The Company states that Ms. Phipps did not express disagreement with the final capital structure reported by the Company.[189]

ii. Staff's Imputed Capital Structure

Staff witness Phipps initially recommended an imputed capital structure including 43.51 percent common equity, 56.03 percent long-term debt and 0.46 percent short-term debt.[190] To arrive at her imputed capital structure, Ms. Phipps began with a three year average equity ratio (for Staff's proxy companies) of 49.91 percent and deducted 6.40 percentage points from that amount.[191] Ms. Phipps' downward adjustment was based on her observation that Standard & Poor's ("S&P") currently rates LUC BBB, whereas the proxy group average credit rating is A-. Reasoning that the difference between BBB and A- represents two of the three credit "notch" differences in a letter grade (*e.g.*, the difference between A and BBB), Ms. Phipps reduced her proposed equity ratio by two-thirds of the difference between the equity ratio benchmarks for Moody's equivalent ratings (*i.e.*, the difference between A and Baa).[192] In rebuttal testimony Ms. Phipps proposed a revised imputed capital structure to correct an inconsistency caused by the LUC capital structure reflecting a short-term debt balance net of CWIP, whereas the proxy groups capital structure did not.[193] Ms. Phipps' proposed revised capital structure consists of 45.59 percent common equity, 53.95 percent long term debt, and 0.46 percent short-term debt.[194]

The Company indicated that the approach adopted by Ms. Phipps is completely ad hoc and with no support in Commission precedent or in financial literature. Ms. Phipps cited to no authority for the manner in which she imputed a capital structure for the Company -- neither in her direct testimony nor her rebuttal testimony. The Company argued that Staff's suggestion that the Company's equity ratio should be reduced to reflect the Company's lower credit rating is misplaced.[195] The Company asserts that a company's credit rating does not determine its equity ratio, rather a company's credit rating is dependent on its equity ratio (among other risk factors).[196] The Company states that authorizing an equity ratio below the Company's current actual equity ratio (and below the equity ratios in place at the proxy group companies) would increase the Company's financial risk, and serve to exacerbate the Company's elevated risk level relative to the proxy group.[197]

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[189] Company Initial Brief at IV.B.i.
[190] Staff Schedule 3.01.
[191] Staff Ex. 3.0 at 5:85-6:101.
[192] *See* Staff Ex. 3.0 at 5:85-6:101.
[193] Staff Ex. 8.0 at 3:48-4:66.
[194] Staff Schedule 8.01.
[195] Company Initial Brief at IV.B.1.ii.
[196] *Id.*
[197] Company Ex. 7.0 Revised 11:183-12:205.

In addition, Mr. Hevert testified that it is unclear that the data Ms. Phipps relied on to develop her proposed ROE adjustment is directly comparable to the data she uses to develop her beginning capital structure estimate.[198] The Company noted that the Commission has previously rejected an imputed capital structure where it expressed concerns about complications caused by the introduction of possible measurement errors to determining the cost of capital.[199]

Mr. Hevert additionally identified areas of Ms. Phipps approach that in his expert opinion are suspect.[200] Mr. Hevert testified that Ms. Phipps relies on reported capital structure data to establish the baseline equity ratio for A-rated utilities on the one hand, and rating agency guidelines to calculate the 6.40 percentage point decrement associated with BBB-rated utilities on the other.[201] Mr. Hevert questioned whether the two are sufficiently comparable that differences in rating agency guidelines can be applied to accounting data for the purpose of creating a reasonable hypothetical capital structure. [202] Mr. Hevert pointed out that Schedule 10.3 -- 2013-2014 Reported Authorized Returns on Equity, Natural Gas Utilities Rate Cases.[203] demonstrates that the average authorized equity ratio since January 2013 for BBB-rated natural gas utilities was 50.07 percent, or 4.48 percentage points above Ms. Phipps' 45.59 percent imputed equity.[204]

Mr. Hevert further stated that there is reason to believe capital structure data may differ from rating agency benchmarks.[205] Mr. Hevert testified that Moody's makes a series of adjustments to the ratio of debt to capitalization and therefore it is quite possible Moody's definition of "total capital" may differ from the data gathered by Ms. Phipps.[206] Mr. Hevert noted that, as to its "standard adjustments", Moody's considers almost a dozen categories for adjustment.[207] Mr. Hevert testified that while it is unclear whether or to what extent those adjustments would be made to the accounting data relied on by Ms. Phipps, the simple fact that Moody's tends to apply such adjustments calls into question the premise of Ms. Phipps' calculation.[208]

Mr. Hevert further noted that Moody's presents guidelines for both its "Standard Grid" and its "Low Business Risk Grid"; it is unclear whether or how Ms. Phipps relied on one or both of those "Grids" in developing her 6.40 percentage point adjustment.[209] Mr. Hevert stated that assuming the midpoint of the ranges (as Ms. Phipps had done)

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[198] *See* Company Ex. 10.0 at 7:142-8:163.
[199] *See* Cent. Ill. Light Co., Docket 06-0070 at 102 (Order, Nov. 21, 2006)(rejecting imputed capital structure in favor of actual capital structure); Company Initial Brief at IV.B.1.ii.
[200] Company Ex. 10.0 at 7:142-8:163.
[201] *Id.*
[202] *Id.*
[203] Company Schedule 10.3
[204] *Id.*
[205] *Id. at* 8:164-10:207.
[206] *Id.*
[207] *Id.*
[208] *Id.*
[209] *Id.*

indicates that the Moody's guidelines imply equity ratios for A-rated companies in the range of 55.00 percent to 60.00 percent.[210] The midpoint of that range, 57.50 percent, is 7.59 percentage points above the 49.91 percent equity ratio that forms the basis of Ms. Phipps' analysis. Applying Ms. Phipps 6.40 percentage point adjustment to the 57.50 percent midpoint produces an adjusted equity ratio of 51.10 percent, which itself is 5.51 percentage points above Ms. Phipps' 45.59 percent hypothetical equity ratio.[211] Mr. Hevert concluded that Ms. Phipps analysis is disconnected from the rating agency benchmarks and must be viewed with caution.[212]

iii. Other Benchmarks

Although the Company believes that its actual capital structure is the correct capital structure for purposes of ratemaking in this case, Mr. Mr. Hevert recognized that the Commission may look to other benchmarks as measures of industry practice and, therefore, as measures of a reasonable imputed capital structure and for confirmation that Ms. Phipps' recommended capital structure is over-leveraged.[213] Mr. Hevert noted that the average authorized equity ratio for BBB-rated gas utilities of 50.07 percent, the overall average authorized equity ratio of 51.48 percent, and the 56.40 percent proxy group average equity ratio are all meaningful benchmarks that may inform the Commission's decision.[214] Mr. Hevert stated that although the average of those data points is 52.65 percent, the middle of the three observations noted above (i.e., 51.48 percent) also would be a reasonable basis for an imputed equity ratio.[215]

b. Staff's Position

c. Commission Conclusion and Analysis

The Commission agrees that the starting point for analysis is the Company's actual capital structure. Based on the evidence in the record, the Commission finds the Company's actual capital structure common equity ratio of 60.10 percent common equity, 39.44 percent long-term debt, and 0.46 percent short-term debt to be reasonable. The Commission notes that the actual capital structure proposed by the Company is within the proxy group common equity. The Commission finds no reason to deviate from the Company's actual capital structure as this represents its actual cost of capital incurred in providing service.

Alternate Introduction]

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[210] *Id.*
[211] *Id.*
[212] *Id.*
[213] Company Ex. 10.0 at 17:345-19:381.
[214] *Id.*
[215] *Id.*

[The Commission agrees that the starting point for analysis is the Company's actual capital structure. However, the Commission believes it is appropriate in this case to adopt an imputed capital structure. The Commission finds that the]

Alternate - 1

[56.40 percent proxy group average common equity ratio represents a reasonable level of equity consistent with the equity ratios of other similarly situated utilities. Therefore, the Commission rejects Staff's proposed imputed capital structure and adopts a capital structure of 56.40 common equity, 43.14 percent long-term debt and 0.46 short-term debt.]

Alternate - 2

[51.48 percent average authorized common equity ratio represents a reasonable level of equity consistent with the equity ratio of other similarly situated utilities. Therefore, the Commission rejects Staff's proposed imputed capital structure and adopts a capital structure of 51.48 common equity, 48.06 percent long-term debt and 0.46 short-term debt.]

Alternate - 3

[50.07 percent average authorized common equity ratio for BBB rated companies represents a reasonable level of equity consistent with the equity ratios of similarly situated utilities. Therefore, the Commission rejects Staff's imputed capital structure and adopts a capital structure of 50.07 common equity, 49.47 percent long-term debt and 0.46 short-term debt.]

2. Cost of Common Equity

a. Legal Standard

Under long established federal and Illinois constitutional law, and Illinois ratemaking law, a utility’s rates must be set so as to allow it the opportunity to obtain full recovery of its prudent and reasonable costs of service, including its costs of capital. The legal standards governing a utility’s right to a fair and reasonable rate of return, in particular, are well established and familiar. A public utility has a constitutional right to a return that is “reasonably sufficient to assure confidence in the financial soundness of the utility and [is] 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.” Bluefield, 262 U.S. at 693. The authorized return on equity “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." Hope, 320 U.S. at 603. The Commission "fully embraces the principles set forth" in the Bluefield and Hope cases. [216]

Further, Section 9-230 of Illinois' Public Utilities Act (220 ILCS 5) specifically addresses financial involvement with nonutility or unregulated companies:

> In determining a reasonable rate of return upon investment for any public utility in any proceeding to establish rates or charges, the Commission shall not include any (i) incremental risk, (ii) increased cost of capital […] which is the direct or indirect result of the public utility's affiliation with unregulated or nonutility companies.[217]

The Company argues that absent substantial defects in a parties' analysis, recent Commission orders have shown a preference towards using an average of the parties DCF and CAPM -- i.e. taking the average of the ROE witnesses' DCF results and combining that with the average of ROE witnesses CAPM results and dividing by two.[218] The Company states that Commission has emphasized that using such an approach is not an endorsement of every input or rationale presented by the parties.[219] The Company argues that Commission has previously stated that such an approach "significantly diminishes any perceived upward or downward bias as set forth in the different positions of the parties."[220] Combining Mr. Hevert's 9.60 percent mean DCF result with Staff's 8.00 percent DCF result would produce an average DCF estimate of 8.80 percent.[221] Combining the 10.68 percent average of Mr. Hevert's standard CAPM results with Staff's 9.72 percent average CAPM result would produce an average CAPM estimate of 10.20 percent.[222] The average of those two estimates (8.80 percent and 10.20 percent) is 9.50 percent. However, both Staff and Mr. Hevert have testified that the Company's level of risk, and therefore required ROE, is higher than the proxy group's average.[223] Adding Staff's 32 basis point incremental risk adjustment to the 9.50 percent average of the DCF and CAPM estimates, the resulting ROE would be 9.82 percent.[224]

Nonetheless, the Company believes that in this case, the Commission

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[216] Consumers Ill. Water Co., Docket No. 03-0403 at 41(Order April 13, 2004).

[217] 220 ILCS 5, Public Utilities Act, Section 9-230.

[218] *See A*meren Ill. Co. Docket No. 13-0192 at 166 (Order, Dec. 18, 2013) ("In determining an appropriate ROE in its rate Orders in Dockets Nos. 11-0282, 12-0511/12-0512, and many other rate cases, the Commission has averaged the DCF and CAPM results which were found to be appropriate"); Peoples Gas Light and Coke Co., Docket 12-0512 (Cons) at 208 (Order, June 18, 2013 (finding an averaging method should be used to determine ROE); Company Initial Brief at IV.B.2.ii.

[219] *See* Ameren Ill. Co. Docket No. 13-0192 at 163 (Order, Dec. 18, 2013).

[220] *Id.*

[221] Company Ex. 7.0, Schedule 7.1; Staff Ex. 8.0 at 2:35-36.

[222] Company Ex. 7.0, Schedule 7.5; Staff Ex. 8.0 at 3:39-40.

[223] Company Ex. 4.0 at 36:656-46:870; Staff Ex. 3.0 at 35:621-625.

[224] Staff Ex. 3.0 at 35:623-625.

should adopt the Company's proposed ROE of 10.50%. As described below, the Company believes this approach reflects a more rigorous ROE analysis as well as a reflection of factors specific to the Company's individual circumstances—particularly the judgment that the Company's particular risk profile would indicate that its ROE should be at the high end of the indicated range.

b. Company's Position

The Company proposed a 10.50% return on equity ("ROE"). Staff witness Phipps proposed that the Company's ROE be set at 9.23%. The Company does not agree with Staff's recommended ROE. Liberty Midstates submitted the expert testimony of Mr. Hevert in support of its requested ROE. Mr. Hevert relied on two widely-accepted approaches to develop his ROE recommendation: the Multi-Stage Discounted Cash Flow ("DCF") model and the Capital Asset Pricing Model ("CAPM").[225] To assess the reasonableness of his DCF and CAPM results, Mr. Hevert also considered the results of a Bond Yield Plus Risk Premium analysis.[226] Mr. Hevert also took into consideration the Company's risk and cost profile, in particular (1) its relatively small size; (2) the regulatory environment in which the Company operates; (3) weather variability; and (4) the direct costs associated with equity issuances.

i. ROE MODELS

The Company presented the testimony of Mr. Hevert in this proceeding which included the DCF model, CAPM, and the Bond Yield Plus Risk Premium approach.[227] Mr. Hevert's analytical approach reflects certain preferences expressed by the Commission in Docket No. 11-0292 and Docket No. 13-0192.[228] Because the ROE is a market-based concept, and Liberty Midstates is not a publicly traded entity, Mr. Hevert established a group of comparable publicly-traded companies to serve as its "proxy."[229] Mr. Hevert applied these models to this proxy group of comparable gas utilities. Mr. Hevert recognized that the Commission has been inclined to consider both the DCF and CAPM approach.[230] Accordingly, Mr. Hevert primarily relied on the DCF model and CAPM, and used the Bond Yield Plus Risk Premium analyses as a corroborating methodology.[231] The Company states that Staff found Mr. Hevert's ROE models and proxy group to be sufficiently reasonable to adopt them in this proceeding, although Staff adjusted certain inputs.[232]

[225] Company Ex. 4.0 at 14:258-262.
[226] Company Ex. 4.0 at 15:283-286.
[227] Company Ex. 4.0 at 3-64-78.
[228] *Id.*
[229] *Id.* at 10:187-13:257.
[230] Company Ex. 4.0 at 8:126-135.
[231] Company Ex. 4.0 at 14:267-270.
[232] *See* Staff Ex. 3.0 at 173-177 (beginning with Mr. hevert's DCF and CAPM).

In direct testimony, Mr. Hevert's ROE analyses, using data as of January 31, 2014, included a mean multi-stage DCF result of 9.94% and an average standard CAPM result of 10.38%.[233] Mr. Hevert reviewed the reasonableness of those estimates using a Bond Yield Plus Risk Premium analysis and an alternate CAPM analysis.[234] In rebuttal testimony, Mr. Hevert updated his ROE analyses using data as of July 31, 2014, Mr. Hevert's updated analyses produce a mean multi-stage DCF result of 9.60% and an average standard CAPM result of 10.68%.[235] Based on this analysis, Mr. Hevert determined that a reasonable range for ROE is 10.00 to 10.50 percent. [236] After considering the Company's regulatory and business risks relative to the proxy group, Mr. Hevert stated that 10.50 percent is a reasonable ROE for Liberty Midstates.[237]

Mr. Hevert updated his analysis in his rebuttal testimony to ensure that the Commission is provided with accurate information. [238] Mr. Hevert's recommended ROE remained unchanged following this update and throughout this proceeding.[239]

a. DCF

The Company stated that DCF model is widely recognized in regulatory proceedings, as well as in financial literature.[240] The Company asserted that the DCF approach is based on the theory that a given stock's current price represents the present value of its expected future cash flows.[241] The Company stated that the DCF model expresses the Cost of Equity as the sum of the expected dividend yield and long-term growth rate.[242]

The Company noted that Mr. Hevert relied on a form of the DCF model referred to as multi-stage DCF.[243] The Company stated that the multi-stage DCF model sets the subject company's stock price equal to the present value of future cash flows received over three "stages".[244] In the first two stages, "cash flows" are defined as projected dividends.[245] In the third stage, "cash flows" equal both dividends and the expected price at which the stock will be sold at the end of the period (*i.e.*, the "terminal price").[246] Mr. Hevert calculated the terminal price based on the Gordon model, which defines the price as the expected dividend divided by the difference between the Cost of Equity (*i.e.*, the discount rate) and the long-term expected growth rate.[247] The Company stated that, in essence, the terminal price is defined by the present value of the remaining "cash flows" in perpetuity.[248] The Company stated that in each of the three stages, the

[233] Company Ex. 4.0 at 6:115-7:118.
[234] *Id.* at 15:279-286.
[235] Company Ex. 7.0 Revised at 6:98-99.
[236] Company Ex. 7.0 Revised at 54:1018-1025.
[237] Company Ex. 4.0 at 8:126-135.
[238] Company Ex. 7.0 Revised at 4:60-65.
[239] Company Ex. 7.0 Revised at 54:1018-1025; Company Ex. 10.0 at 41:782-788.
[240] Company Ex. 4.0 at 15:296-300.
[241] Company Ex. 4.0 at 15:302-16:325.
[242] Company Ex. 4.0 at 15:294-297.
[243] Company Ex. 4.0 at 17:326-339.
[244] *Id.*
[245] *Id.*
[246] *Id.*
[247] *Id*
[248] *Id*

dividend is the product of the projected earnings per share and the expected dividend payout ratio.[249]

The Company noted that Staff agreed that the Multi-Stage DCF model should be relied upon, but adjusted certain input assumptions including: (1) removing the "sv" component of the sustainable growth formula; (2) assuming the long-term payout ratio will remain constant after Value Line's 2017-2019 projection period; and (3) assuming a percent 4.67 long-term growth rate (updated from 4.76 percent in Staff's direct testimony).[250]

The Company argued that Staff's removal of the "sv" component of the Retention Growth model is not appropriate. The Company stated that the Retention Growth estimate allows for earnings growth through reinvested earnings as well as earnings growth funded through external equity.[251] The Company stated that Ms. Phipps explained that she excluded the "sv" component because she believes Value Line forecasts no new common equity share issuances for the proxy companies.[252] The Company noted that Ms. Phipps' belief that Value Line does not forecast new common equity share issuances for the proxy companies is clearly incorrect.[253] The Company stated that Company Schedule 7.2 shows that Value Line projects six out of nine proxy companies to increase their common shares outstanding from 2014 through the 2016 - 2018 forecast period.[254] The Company argues that Ms. Phipps' recommendation has not been adjusted to remove this error.

The Company also does not agree with Staff's assumption that the long-term payout ratio will remain constant. The Company argues that Ms. Phipps stated that historical data may reflect condition that may not continue in the future and alleged that investors are indifferent as to whether their returns come from dividends or capital appreciation.[255] However, Liberty Midstates asserts that companies adjust their payout ratios to reflect changing capital investment cycles.[256] The Company asserted that by relying on Value Line's forecasted payout ratios for the 2017-2019 period, Ms. Phipps has essentially picked a point in the proxy companies' capital investment cycles and has assumed it represents the long-term (that is, in perpetuity) expected financing practices of those companies.[257] The Company stated that is more reasonable to consider historical data (as Mr. Hevert did) that covers a range of capital market conditions and individual utility capital investment levels. The Company argued that the calculation in Mr. Hevert's model represents a reasonably long period and is an appropriate estimate of the expected payout ratio.[258] The Company noted that Ms. Phipps has not suggested any alternative time period, nor has she demonstrated Mr. Hevert's analysis is inappropriate.

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[249] *Id.*
[250] Staff Ex. 3.0 at 11:182-197; Staff Ex 8.0 at 2:31-35.
[251] Company Ex. 7.0 Revised at 26:493-509.
[252] Staff Ex. 3.0 at 13:220-228.
[253] Company Ex. 7.0 Revised at 27:517-527.

[255] Staff Ex. 8.0 at 16:270-277.
[256] Company Ex. 10.0 at 409-434.
[257] Company Ex. 10.0 at 21:411-22:434.
[258] *Id.*

The Company also noted that payout ratios for gas utility companies are currently at the low end of observed historical levels.[259] The Company believes it is reasonable to assume the currently low payout ratios are related to the elevated level of capital expenditures the industry is facing in the near term and therefore can be expected to increase over time.[260] The Company states that Ms. Phipps provided no empirical support for her implicit assumption that there has been a permanent, structural downward shift in natural gas utility company payout ratios. Consequently, the Company believes it remains reasonable to assume that over the long-term, dividend payout ratios for gas utility companies will converge to their long-term historical median of 68.85 percent.[261]

The Company additionally disagrees with Staff's use of a long term GDP growth rate of 4.67 percent. The Company states that Ms. Phipps relies on projected real GDP growth estimates from both the Energy Information Administration ("*EIA*") and Global Insight that end from approximately 26 to 30 years from now, while Mr. Hevert considered the long-term average real GDP growth rate over the 1929 to 2013 period.[262] The Company argues that Ms. Phipps' reliance on the EIA and Global Insight's forecasts results in an unreasonably low nominal growth rate in the context of historical growth rates.[263] The Company noted that Mr. Hevert cited to several examples industry literature indicating that investors expect companies to grow at historical average rates.[264] Additionally, the Company argued that a 4.67 percent long-term growth rate is not consistent with the growth rate implied by recently authorized ROEs.[265]

Mr. Hevert's final DCF calculation provided in rebuttal contained a low of 9.28%, a mean of 9.6% and a high of 10.05%.[266]

b. CAPM

The Company describes the CAPM analysis as a risk premium method that estimates the Cost of Equity for a given security as a function of a risk-free return plus a risk premium (to compensate investors for the non-diversifiable or "systematic" risk of that security).[267] The Company states that in Docket 13-0192, the Commission stated its preference for (1) Beta coefficients calculated over five years; and (2) the exclusion of non-dividend paying companies from the DCF analysis when calculating the required market return.[268] Mr. Hevert performed his CAPM analyses reflecting those preferences. [269]

The Company stated that Mr. Hevert's approach to estimating the Market Risk Premium ("*MRP*") is based on the market-required return, less the current 30-year

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[259] Company Ex. 10.0 at 22:438-439.
[260] *Id.* at 22:438-23:451.
[261] *Id.*
[262] Company Ex. 10.0 at 23:457-567.
[263] Company Ex. 10.0 at 26:501-505.
[264] Company Ex. 10.0 at 26:506-534.
[265] Company Ex. 10.0 at 28:535-546.
[266] Company Ex. 7.0 at 5:91-6:99.
[267] Company Ex. 4.0 at 24:450-454.
[268] *See* Ameren Ill. Co., Docket No. 13-0192 at 164-165 (Order, December 18, 2013).
[269] Company Ex. 4.0 at 3:54-63.

Treasury bond yield.[270] To estimate the market required return, Mr. Hevert calculated the market capitalization weighted average ROE based on the Constant Growth DCF model relying on data from two sources: Bloomberg and Value Line. [271] Mr. Hevert selected a 30-year yield because natural gas utilities typically are long-duration investments and as such, the 30-year Treasury yield is more suitable for the purpose of calculating the Cost of Equity.[272]

The Company stated that Mr. Hevert considered two methods of calculating the Beta coefficient. [273] The first approach simply employs the average reported Beta coefficient from Value Line for each of the proxy group companies. [274] Mr. Hevert also calculated Beta coefficients over five years using monthly returns.[275] Mr. Hevert calculated the "raw" Beta coefficient for each member of the proxy group and adjusted those raw Beta coefficients to address the tendency to regress toward the market Beta coefficient of unity. [276] For the purpose of that calculation, Mr. Hevert relied on monthly returns, and performed a regression analysis of the data over the five-year period ended January 31, 2014. [277]

The Company noted that Staff agrees that reliance on the CAPM approach is appropriate, including the use of a 30-day average 30-year treasury yields as the risk-free rate and an MRP based on a similarly derived, forward-looking expected market return.[278] Liberty Midstates asserts that the Company and Staff disagree over (1) the selection of the risk-free rate component of the model; (2) the appropriate Beta Coefficients; and (3) the calculation of the expected return on the overall market, which is used to determine the ex-ante MRP. [279]

Staff witness Phipps claims that it is a flaw to use the forecasted U.S. Treasury bond yield as a proxy for the risk-free rate of return.[280] The Company explained that the Cost of Equity is a forward-looking concept. The Company asserted that because the purpose of this proceeding is to establish the Cost of Equity for Liberty Utilities' gas utility operations on a forward-looking basis, it is necessary to develop a CAPM analysis that reflects investor expectations concerning the risk-free rate.[281] Mr. Hevert observed that Ms. Phipps calculates an implied 20-year forward U.S. Treasury yield in ten years of 4.27 percent as part of her calculation of expected inflation using the TIPS spread; that estimate is 71 basis points above the 3.56 percent 30-day average 20-year Treasury yield as of the same date). [282] The Company asserts that calculation clearly shows an expectation of rising interest rates. [283] The Company noted that Blue Chip's

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[270] *Id.* at 27:486-502.
[271] *Id.* at 27:492-510.
[272] *Id.* at 29:535-539.
[273] *Id.* at 28:503-510.
[274] *Id.*
[275] *Id.*
[276] *Id.* at 28:511:521.
[277] *Id.*
[278] Company Ex. 7.0 Revised at 8:125-133.
[279] Company Ex. 10.0 at 587-591.
[280] Staff Ex. 3.0 at 21:363-367.
[281] Company Ex. 10.0 at 31:592-598.
[282] Company Ex. 7.0 Revised at 36:675-37:693.
[283] *Id.*

near-term forecast of the 30-year Treasury yield, which is the consensus projection of over fifty business economists for the average 30-year U.S. Treasury yield in the coming six quarters, also indicates investors expect interest rates to rise. [284]

The Company states that expectations for rising interest rates are not surprising given the ongoing tapering of the Federal Reserve's Quantitative Easing program (which was intended to lower long-term rates) that started in December 2013. [285] Therefore, the Company argues, it is appropriate to consider both current and projected 30-year Treasury yields when estimating the risk-free rate component of the CAPM. [286]

The Company asserts that Mr. Hevert's primary analyses reflect the Commission's preference for Beta coefficient calculated over five-years. [287] Mr. Hevert also believes it is important to consider Beta coefficient estimates that reflect current and expected levels of systematic risk. [288] Therefore, Mr. Hevert also performed an alternate set of CAPM analyses using Bloomberg Beta coefficient which are calculated over two-years and regression Beta coefficient calculated over 18-months. [289] The Company states that Staff believes the alternate CAPM Beta coefficients are calculated over too short of a time period to be reliable and are "more prone to measurement error arising from short-term changes in risk and investor risk preferences".[290]

Mr. Hevert noted that a five-year period is not required to calculate beta. [291] Mr. Hevert observed Ms. Phipps' Beta coefficient estimates do not cover a full business cycle.[292] The Company states that looking at Beta coefficients over differing periods, as Mr. Hevert has done, is entirely consistent with industry practice and provides additional information and perspective that should not be disregarded. [293] The Company argues that Ms. Phipps' concern about statistical relevance overlooks the fact that Mr. Hevert's 18-month Beta coefficient relies on more observations than at least two of Ms. Phipps' estimates. [294] The Company stated that Ms. Phipps' regression Beta and Zacks' Beta coefficients compare the monthly returns of a given company relative to a market index (*i.e.*, five years result in 60 observations), Mr. Hevert compares the monthly returns of the subject company to the S&P 500 on a daily basis (*i.e.,* the monthly returns for each trading day in the 18 months, which results in 379 trading days). [295]

The Company argued that the MRP estimates in Mr. Hevert's analyses are quite reasonable relative to the observed MRPs from 1926 to 2013. The Company asserted that Staff witness Phipps' suggestion that these estimates are too high fails to recognize that the mean and median long-term Treasury yields over the same period were substantially higher (5.09 percent and 4.26 percent, respectively).[296] The Company

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[284] *Id.*
[285] *Id.*
[286] *Id.*
[287] Company Ex. 7.0 Revised at 39:730-736.
[288] *Id.*
[289] *Id.*
[290] Staff Ex. 3.0 at 27:482-28:484.
[291] Company Ex. 7.0 Revised at 39:737-40:763.
[292] Company Ex. 7.0 Revised at 40:773-41:778.
[293] Company Ex. 7.0 Revised at 43:812-814.
[294] *Id.* at 43:815-836.
[295] *Id.*
[296] Company Ex. 10.0 at 35:668-686.

stated that because the MRP is calculated as the expected market return less the yield on long-term government bonds, it is quite reasonable for the current MRP to be moderately above the long-term average.[297]

The Company stated that taking into consideration the volatility of historical MRPs, even the highest of Mr. Hevert's MRP estimates is statistically indistinguishable from the historical mean at a 95.00 percent confidence interval.[298] Therefore, the Company asserts that Mr. Hevert's *ex-ante* market-DCF derived MRPs used in his CAPM analyses are reasonable.

c. Bond Yield Plus Risk Premium

Mr. Hevert used the Bond Yield Plus Risk Premium method to corroborate the reasonableness of his DCF and CAPM estimates. This stated that this approach is based on the basic financial tenet that, since equity investors bear the residual risk associated with ownership and therefore require a premium over the return they would have earned as a bondholder. [299] That is, since returns to equity holders are more risky than returns to bondholders, equity investors must be compensated for bearing that risk. [300] Risk premium approaches, therefore, estimate the Cost of Equity as the sum of the equity risk premium and the yield on a particular class of bonds. [301]

Mr. Hevert first defined the Risk Premium as the difference between authorized ROEs and the then-prevailing level of long-term (*i.e.*, 30-year) Treasury yields. [302] Next, Mr. Hevert gathered data from 988 natural gas rate proceedings between January 1, 1980 and January 31, 2014. [303] In addition to the authorized ROE, Mr. Hevert calculated the average period between the filing of the case and the date of the final order (the lag period). [304] In order to reflect the prevailing level of interest rates during the pendency of the proceedings, Mr. Hevert calculated the average 30-year Treasury yield over the average lag period (approximately 187 days).The Company stated that because the data covers a number of economic cycles, the analysis also may be used to assess the stability of the Equity Risk Premium.[305] Mr. Hevert testified that prior research has shown the Equity Risk Premium is inversely related to the level of interest rates.[306] The Company noted this analysis is particularly relevant given the relatively low, but increasing level of current Treasury yields. [307]

The results of this approach results in an implied ROE between 10.17 percent and 10.68 percent. [308] The Company argues that while the Commission has not relied on returns authorized to other utilities when determining the appropriate authorized ROE for a particular utility, it has recognized the value of observing general market

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[297] *Id.*
[298] *Id.* Assuming a 10.32 percent mean MRP estimate, 88 MRP observations, the 6.95 percent mean MRP, and the 20.29 percent historical standard deviation.
[299] Company Ex. 4.0 at 32:585-33:597.
[300] *Id.*
[301] *Id.*
[302] *Id.* at 33:600-607
[303] *Id.*
[304] *Id.*
[305] *Id.* 33:608-609.
[306] *Id.* at 33:309-34:612.
[307] *Id.*
[308] *Id.* at 35:634-638.

conditions and trends, including the recent average of authorized ROEs, when assessing parties ROE recommendations.[309]

ii. Staff's ROE Recommendation Is Not Reasonable

The Company stated that prior to a 32-basis point credit rating adjustment, Staff is recommending an ROE of 8.91% which is below recently authorized natural gas ROEs in Illinois and other jurisdictions. Staff's unduly low ROE estimate was determined by giving 50% weight to a multi-stage DCF result of 8.26% (updated to 8.00% in rebuttal testimony), which is more than 80 basis points below the lowest authorized ROE for a natural gas utility since at least January 2013.[310] The Company noted that after applying a 32 basis point upward adjustment to Ms. Phipps' ROE estimate to reflect the Company's relatively lower credit rating compared to the proxy group average credit rating, Ms. Phipps' 9.32% ROE recommendation is well below the average authorized natural gas ROE since January 2013 of 9.65%.[311]

The Company argued that Staff's unreasonably low ROE estimate is due to notable flaws in Staff's analysis that were addressed in the testimony of Mr. Hevert. Most significantly, the Company noted that Staff's Non-Constant Growth DCF result relies on the unfounded assumption that near-term projections from Value Line (for dividend payout ratios) and medium-term projections from the Energy Information Administration and Global Insights (for real GDP growth) reflect investors' expectations for the long-term (i.e., in perpetuity).[312] Mr. Hevert, on the other hand, relied on the more reasonable assumption that earnings growth and dividend payout ratios would revert toward long-term observed historical averages over time.[313]

The Company stated that Ms. Phipps' DCF analysis is also fundamentally flawed because of her mistaken exclusion of the "sv" component based on her demonstrably incorrect belief that Value Line does not forecast new common equity share issuances for the proxy companies.[314]

Additionally, the Company asserts that Staff's CAPM model failed to recognize market expectations for rising interest rates. Mr. Hevert's analysis, however, reflects the consensus view of over fifty business economists surveyed for Blue Chip's monthly Financial Forecast publication. [315]

c. Staff's Position

[Insert]

d. Commission's Conclusion and analysis

The Commission finds that a 10.50% return on equity is fully supported by the record and is therefore adopted.

C. Approved Overall Rate of Return

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[309] Peoples Gas and Light Co., Docket 12-512 at 205 (Order, June 18, 2013).
[310] Company Ex. 7.0 Revised at 4:70-79.
[311] *See* Schedule 7.13.
[312] Company Ex. 7.0 at 28:542-29:552; Company Ex. 10.0 at 25:472-26:505.
[313]Company Ex. 7.0 Revised at 32:598:612; Company Ex. 10.0 at 27:499-:28:534.
[314] Company Ex. 7.0 Revised at 27:517-527.
[315] *Id.* at 36:683-37:687.

	Proportion	Cost	Weighted Cost
Short Term Debt	0.46%	1.41%	. 0.01%
Long Term Debt	39.44%	4.81%	1.65%
Common Equity	60.10%	10.50%	6.31%
Total	100.00%		7.97%

D. Ability to Satisfy Docket No. 11-0559 Condition

1. Company's Position

The Company stated that in Docket 11-0559, the Commission ordered that:

> For the next rate proceeding for Liberty Energy Midstates, the pre-tax cost of capital will be set using no higher than the lower of (1) the pre-tax cost of capital that Liberty Energy Midstates would have had if (a) its debt to equity ratio was the same as Atmos' equity ratio as of September 30, 2011 (including short-term debt), and (b) the cost of its debt were the same as the cost of debt held by Atmos on September 30, 2011, and (2) the pre-tax cost of capital based on the actual capital structure of Liberty Energy Midstates. The FERC Form 2 Annual Report for the year ended December 31, 2011 will be used as the basis for the purpose of calculating the cost of debt for Atmos. (Section 7-204(b)(7)).[316]

Accordingly, the Company observed that Condition 9 may impose a limitation on weighted cost of capital that the Company may recover in this case. The Company stated that the Commission identified two possible approaches to determining the pre-tax cost of capital, one using the Company's actual capital structure, and one using its predecessor's capital structure and cost of debt. The Company states that it is required to use the lower of the two. Therefore if the Company's actual capital structure results in a lower pre-tax cost of capital, no adjustment is necessary. If, however, the Company's actual capital structure results in a higher pre-tax cost of capital, an adjustment is necessary to reduce the cost of capital in this case to that which would be determined using its predecessor's capital structure and cost of debt.

The Company presented a calculation of the Condition 9 adjustment under its actual capital structure as well as the three benchmark capital structures identified by Mr. Hevert.[317] In its Initial Brief, the Company corrected a clear error—the Company's cost of debt was transposed from 4.81 percent to 4.18 percent. The Company stated that based on the revised schedule, the use of the Company's actual capital structure, cost of equity and rate base, the overall revenue requirement would need to be adjusted downwards by $344,918 to reflect the application of Condition 9.

2. Staff's Position

[insert]

3. Commission's Conclusion and Analysis

[316] Atmos Energy Corporation and Liberty Energy (Midstates) Corp., Docket 11-0559 (Order, Appendix A, June 27, 2012).

[317] Company Ex. 10.0 at 19:378-387.

Based on the approved capital structure, cost of equity, and rate base, the Commission finds that a downward adjustment of $344,918 is required to satisfy condition 9.

V. COST OF SERVICE

As part of every rate case, the Commission must determine which portion of a utility's costs each class of customer will be responsible for. Generally, the Commission prefers to allocate costs among the various classes as close to the cost of serving each class as is reasonably possible and/or appropriate. The purpose of doing so is to assign costs to those customers that cause them. The Commission typically accomplishes this goal through a cost of service ("COS") study. A COS compares the cost each customer class or subclass imposes on the utility's system to revenues produced by each class or subclass. A properly performed COS shows the cost to serve each class or subclass and the ROR for each class or subclass. Customer classes or subclasses with a ROR equal to the total system ROR are paying their cost of service. Customer classes paying less than the total system ROR are not paying their cost of service. From time to time circumstances arise that warrant allocating costs at least in part on non-cost based criteria.

The Company presented a COS study in its direct testimony.[318] The Company's COS study shows by customer class the distribution of revenue responsibility necessary to achieve equalized rates of return on investment at the Company's proposed revenue requirement.[319] The Company's COS study identifies the revenues, costs, and profitability for each customer class.[320] It also serves as a partial basis for the Company's proposed rate design.[321] Generally, the Company prepared the COS study utilizing three major steps: (1) functionalization; (2) cost classification; and (3) cost allocation of all the cost of the utility's system to customer classes.[322]

Staff did not object to the Company's COS nor did Staff present its own COS. Staff witness Boggs concluded the Company's COS study appropriately assigns costs to the various functions and rate classes.[323]

The Commission concludes that Liberty Midstates' COS study is complete and systematically functionalize, classify and allocate costs, and comport with the cost allocation principles for preparing such studies that the Commission has approved in many other rate cases. Accordingly, the Commission finds that Liberty Midstates' COS study is sufficient and reasonable for allocating and designing rates in this proceeding.

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[318] Company Schedule 3.1.
[319] Staff Ex. 4.0 at 5:85-92
[320] *Id.*
[321] *Id.*
[322] *Id.*
[323] Staff Ex. 4.0 at 13:254-260.

VI. RATE DESIGN

A. Overview

The Company and Staff agreed that the Company's proposed rate design is reasonable and should be adopted.[324] The Company did not base the customer charges strictly on the COS study.[325] Instead, the Company used what it described as a "sensitivity allocation" approach to determine customer charges for each class of service.[326] Under this approach, the Company applied the overall 38.54% revenue increase only to the residential class.[327] The other proposed revenue increases applied by the Company were 41.32% to the commercial class and 20% to the industrial class.[328] Company witness Long stated this approach used both the iterative process as well as his professional judgment to mitigate the extreme results of other approaches.[329] Mr. Long explained that his main consideration for this approach is the very small industrial class that consists of only eight customers.[330] Mr. Long explained that a purely cost based revenue allocation would produce a large rate increase for this class.[331] Mr. Long used the class revenue allocations and the billing determinants from the forecasted test year to calculate the amount needed on a monthly basis from each customer class to recover the customer-related costs related to providing natural gas service.[332]

Staff witness Boggs testified that he assessed the proposed class revenue allocations and proposed customer charges presented by the Company. Mr. Boggs compared the proposed rates with the rates that would result based on the COS study.[333] Mr. Boggs determined that under a strictly cost-based approach, residential customer charges would nearly double from their current levels.[334] For commercial customers the customer charge would decrease but usage charges would more than double.[335] For the industrial classes, customer charges would have increased four-fold and usage charges would have to more than triple to meet the proposed test year revenue requirement.[336] Mr. Boggs concluded that cost based rates shaped solely by the COS study would produce excessive increases to the industrial class customer charge and usage charge such that the needed increases would most likely have an adverse impact on the monthly bills of the eight industrial customers.[337] Mr. Boggs

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[324] Staff Ex. 4.0 at 22:427-428; Company Ex. 6.0 at 18:403-19:409.
[325] *Id.* at 16:318-327.
[326] *Id*. at 17:329-344.
[327] *Id.*
[328] *Id.*
[329] *Id;* Company Ex. 4.0 at 44:944-966.
[330] Company Ex. 4.0 at 44:944-966.
[331] *Id;* Staff Ex. 4.0 at 17:343-344
[332] Staff Ex. 4.0 at 17:348-18:352.
[333] Staff Ex. 4.0 at 18:356-359.
[334] *Id*. at 20:375-383.
[335] *Id.*
[336] *Id.*
[337] *Id.* at 20:385-21-393.

further stated the decline in the commercial class customer charge indicates a different rate design could be developed.[338]

Mr. Boggs then concluded that the rate design proposal presented by the Company is the most appropriate.[339] Mr. Boggs noted that the Company's proposal still requires large percentage increases in the customer charge for each customer class.[340] Mr. Boggs recommended that the Commission approve the Company's rate design and revenue allocation proposal.[341] Mr. Boggs noted that after fifteen years without any rate increases, the cost to serve Liberty Midstates customers has increased considerably and all customers will receive a significant increase.[342]

B. Residential

The Company proposed to increase the current $9.90 customer charge to a $23.00 fixed monthly customer charge and initially proposed a per therm usage charge of $.02459.[343] Staff recommended that the Commission approve the Company's proposed customer charge and that the remainder of the revenue requirement, as adjusted by the Commission, be collected through the usage charge.[344] The Company agreed with Staff's recommendation.[345]

C. Commercial

The Company proposed to increase the current $25 customer charge to an $80.00 fixed monthly customer charge and initially proposed a per therm usage charge of $.2244.[346] Staff recommended that the Commission approve the Company's proposed customer charge and that the remainder of the revenue requirement, as adjusted by the Commission, be collected through the usage charge.[347] The Company agreed with Staff's recommendation.[348]

D. Industrial

The Company proposed to increase from the current $100 customer charge to a $200 fixed monthly customer charge and initially proposed a per therm usage charge of $.3450.[349] Staff recommended that the Commission approve the Company's customer charge and that the remainder of the revenue requirement, as adjusted by the

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338 *Id.*
339 *Id*. at 21:397-410.
340 *Id.*
341 *Id.* at 22:427-432.
342 *Id.*
343 Company Schedule 3.4.
344 Staff Ex. 4.0 at 22:425-23:445
345 Company Ex. 6.0 at 19:404-408.
346 Company Schedule 3.4.
347 Staff Ex. 4.0 at 22:425-23:445.
348 Company Ex. 6.0 at 19:404-408.
349 Company Schedule 3.4.

Commission, be collected through the usage charge.[350] The Company agreed with Staff's recommendation.[351]

E. Customer Classes 150, 190, 191, and 192

Liberty Midstates currently has no customers under Customer classes 150, 190, 191, and 192. The Company stated that it did not intend to update or eliminate these customer classes because a new customer in the future may take services under these classes. Staff witness Boggs recommends in the event a new customer takes services under one of the aforementioned customer classes, that the Company be required to perform a new COS study. The Company agreed with Staff's recommendation.

F. Commission Conclusion and Analysis

The Commission is satisfied that the rate design agreed to between Liberty Midstates and Staff is appropriate. The fixed monthly customer charges will be as proposed by the Company. The remainder of the revenue requirement will be collected through the usage charge for each class of customers, in the proportions proposed by Mr. Long as recommended by Mr. Boggs.

The Commission further finds that if a new customer begins to take service under customer classes 150, 190, 191, or 192, Liberty Midstates shall be required to perform and provide a new cost of service study within 60 days and for the Company and Staff to determine what appropriate further action is needed, if any.

VII. <u>OTHER ISSUES</u>

A. Quality of Future Rate Filings and Reports

1. Staff's Position

[Insert]

2. Company's Position

The Company stated that this proceeding presented unique challenges that are not anticipated to be present in future rate cases.[352] The Company notes that its longer operating history at the time of next rate case will enable it provide the Part 285 schedules entirely from its own records, eliminating delays in retrieving data from its predecessor.[353] The Company identified its short operating history and the more than fourteen years since its predecessor's last rate case.[354] The Company stated it has the

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[350] Staff Ex. 4.0 at 22:425-23:445.
[351] Company Ex. 6.0 at 19:404-408.
[352] Company Ex. 5.0 at 23:501-24:521.
[353] *Id.*
[354] *Id.*

ability to and will provide more complete supporting documentation in its next rate case filing.[355]

The Company indicated that the Commission already has in place procedures to ensure that the Commission has the necessary data for it to make a determination. In fact, those procedures were followed to rectify deficiencies in this case to ensure that the Commission had all necessary information. The Company did express that it understood that the process was not ideal from Staff's perspective, and highlighted Staff's cooperation and efforts in working with the Company in this case.

The Company expressed concerns that the adoption of Company-specific requirements based on the unique circumstances for this rate case will subject it to a regulatory regime that is not applicable to any other utility and that it may be administratively difficult to comply with. In its brief, the Company suggested that changes to the Form 21 requirements may be better suited for a rulemaking proceeding. Subject to the Company's concern, the Company indicated it believes it could use reasonable efforts to comply with making certain otherwise inapplicable Form 21 requirements applicable to the Company as proposed by Staff. Liberty Midstates urged that in the event the Commission adopts Staff's proposal, that it be limited in time to the next rate case filed by the Company, after which the need for any such obligations could be re-assessed. The Company stated that it is willing to use reasonable efforts on an informal basis to provide Staff with requested information (making certain otherwise inapplicable Form 21 requirements applicable to the Company) between now and the next rate case.[356] The Company, however, suggests that imposing Company-specific Form 21 requirements in the context of a rate case bypasses the more structured approaches to rulemaking from which the Form 21 requirements originate.[357] Liberty Midstates stated that Company-specific requirements are also difficult to interpret other than on a reasonable efforts basis, because Commission guidance on interpretation of one set of rules would not apply to these special requirements applicable only to the Company.[358]

3. Commission's Conclusion and Analysis

The Commission understands that unique circumstances were present in this proceeding due to Liberty Midstates short operating history and the length of time between rate cases for this service area. Because these circumstances will not be present during the Company's next rate case, the Commission expects, as the Company has stated, that the Company will be able to provide a more complete initial Part 285 filing and that it will significantly improve the quality of supporting documentation.

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[355] *Id.*
[356] Company Initial Brief at VII.A.
[357] Company Initial Brief at VII.A.
[358] Company Initial Brief at VII.A.

The Commission declines to impose utility-specific Form 21 requirements on Liberty Midstates. However, the Commission recognizes the Company's stated willingness to use reasonable efforts on an informal basis to provide Staff with requested information (making certain otherwise inapplicable Form 21 requirements applicable to the Company) between now and the next rate case.

B. Property Tax Regulatory Asset

1. Company's Position

The Company will establish a new office building in Vandalia during the test year.[359] The Company states that property taxes will not be assessed until the following year.[360] Staff asserts this timing difference means the Company cannot recover property taxes in rates resulting from this proceeding because the first time taxes will be incurred falls outside the test year.[361]

The Company did not contest Staff's position regard the incorporation of these taxes into rates in this case. However, the Company seeks approval to treat the property taxes paid on this property between now and its next rate case as a regulatory asset for which it can seek recovery separately in its next rate case proceeding.[362] Mr. Long testified this is appropriate because the taxes are recurring costs of determinable amounts, they are used to provide service, and they are relatively large for a utility of the Company's size.[363] In addition, Mr. Long stated that this is a unique circumstance because the test year happens to be the first year in which the building operates and it is only during this year that the property taxes are not assessed[364]. In any other year, the property taxes will be assessed and paid.[365]

In response to Staff's testimony that the treatment of these taxes as a deferred asset was precluded by the Commission's decision in Docket 98-0895 regarding Y2K costs, the Company pointed out that unlike the property taxes for which it is requesting deferred asset treatment, the Y2K costs involved one-time non-recurring costs that would not be incurred year after year.[366]

2. Staff's Position

[Insert]

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[359] Company Ex. 6.0 at 9:187-188.
[360] *Id.* at 9:189-191.
[361] Staff Ex. 1.0 at 9:171-175.
[362] Company Ex. 6.0 at 9:198-201.
[363] Company Ex. 9.0 at 5:91-97.
[364] *Id.*
[365] *Id.*
[366] Company Ex. 9.0 at 4:73-81.

3. Commission's Conclusion and Analysis

Having considered the evidence, the Commission finds that Liberty Midstates shall be entitled to treat the property taxes related to the Vandalia office building as a regulatory asset for which it can seek recovery separately in its next rate case proceeding.

VIII. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record herein and being fully advised in the premises is of the opinion and finds that:

(1) Liberty Midstates is a Missouri corporation engaged in the distribution of natural gas to the public in Illinois and is a public utility as defined in Section 3-105 of the Act;

(2) the Commission has jurisdiction over the parties and subject matter herein;

(3) the recitals of fact and conclusions of law reached in the prefatory portion of this Order are supported by the evidence of record, and are hereby adopted as findings of fact and conclusion of law; the Appendices attached hereto provide supporting calculations;

(4) the test year determination of rates herein found to be just and reasonable should be the 12 months ending December 31, 2015; such test year is appropriate for the purposes of this proceeding;

(5) the $52,686,071 original cost of plant for Liberty Midstates at December 31, 2013 is unconditionally approved as the original cost of plant;

(6) for the test year ending December 31, 2015, and for the purposes of this proceeding, Liberty Midstates' original cost rate base with adjustments is $39,922,399;

(7) a just and reasonable return which Liberty Midstates should be allowed to earn on its net original cost rate base is %; this rate of return incorporates a return on equity of 10.50% and costs of long-term debt of 4.81%, and short-term debt of 1.41%, with a just and reasonable capital structure of 60.10% common equity, 39.44% long-term debt and 0.46% short-term debt;

(8) Liberty Midstates rate of return set forth in Finding (7) results in approved base rate net operating income of $

(9) Pursuant to Section 9-229 of the Act, the Commission has specifically assessed the amounts expended by the Liberty Midstates to compensate attorneys and experts to prepare and litigate this general rate case filing and finds the rate case expense amount of $865,478 to be just and reasonable;

(10) Liberty Midstates' rates, which are presently in effect, are insufficient to generate the operating income necessary to permit Liberty Midstates the opportunity to earn a fair and reasonable rate of return on net original cost rate bases; these rates should be permanently cancelled and annulled;

(11) the specific rates proposed by Liberty Midstates would produce a rate of return in excess of a return that is fair and reasonable; Liberty Midstates' proposed rates should be permanently cancelled and annulled consistent with the findings herein;

(12) Liberty Midstates should be authorized to place into effect tariff sheets designed to produced annual rate base revenues of $, in addition to $ of other revenues, which represents a total rate increase of $ or % in base rate revenues; such revenues will provide Liberty Midstates with an opportunity to earn the rate of return set forth in Finding (7) above; based on the record in this proceeding, this return is just and reasonable;

(13) the new tariff sheets shall reflect an effective date not less than five working days after the date of filing, with the tariff sheets to be corrected within that time period if necessary, except as is otherwise required by Section 9-201(b) of the Act;

(14) if a new customer begins to take service under customer classes 150, 190, 191, or 192, Liberty Midstates shall be required to perform and provide a new cost of service study within 60 days and for the Company and Staff to determine what appropriate further action is needed, if any;

(15) Liberty Midstates is authorized to treat property taxes incurred from the Vandalia office building as a regulatory asset for which it may seek recovery in its next rate case;

(16) Liberty Midstates shall report semi-annually to the Manager of Accounting to the Commission its progress in complying with the plan set forth in Exhibit 8.02 regarding affiliate service agreement costs. The report shall be titled "Status Report of Progress Costs charged to Liberty Midstates/Illinois from Affiliates." The first report will be provided October 2015 and subsequent reports shall be provided at six-month intervals until the items set forth in the plan are complete.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the tariff sheets presently in effect for Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities are hereby permanently cancelled and annulled effective at such time as the new gas delivery tariff sheets approved herein become effective by virtue of this Order.

IT IS FURTHER ORDERED that the proposed tariffs seeking a general increase in gas rates, filed by Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities on March 31, 2014 are permanently cancelled and annulled.

IT IS FURTHER ORDERED that Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities is authorized to file new tariffs sheets in accordance with Findings (6) through (13) of this Order, applicable to gas delivery service furnished on and after the effective date of said tariffs.

IT IS FURTHER ORDERED THAT Liberty Midstates shall report semi-annually to the Manager of Accounting to the Commission its progress in complying with the plan set forth in Exhibit 8.02 regarding affiliate service agreement costs. The report shall be titled "Status Report of Progress Costs charged to Liberty Midstates/Illinois from Affiliates." The first report will be provided October 2015 and subsequent reports shall be provided at six-month intervals until the items set forth in the plan are complete.

IT IS FURTHER ORDERED THAT if a new customer begins to take service under customer classes 150, 190, 191, or 192, Liberty Midstates shall be required to perform and provide a new cost of service study within 60 days and for the Company and Staff to determine what appropriate further action is needed, if any;

IT IS FURTHER ORDERED that all motions, petition, objections, and other matters in this proceeding which remain unresolved are disposed of consistent with the conclusions herein.

IT IS FURTHER ORDERED THAT subject to the provisions of Section 10-113 of the Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this [*] day of [month], 2014.