

STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

DE 13-063

Granite State Electric Company d/b/a Liberty Utilities
Distribution Service Rate Case

DIRECT TESTIMONY
OF
JAMES J. CUNNINGHAM JR.

Date: November 15, 2013

Table of Contents

<u>Description</u>	<u>Page</u>
I. Introduction and Summary	1
II. Depreciation and Amortization Expense	2
A. Summary of GSEC Proposal	2
B. Summary of Staff Proposal	3
C. Average Service Life Analysis	5
D. Net Salvage Analysis	8
III. Depreciation-related Rate Base Adjustments	12
A. Summary	12
B. Methodology	12
IV. Employee Benefits and Expenses	13
A. Summary	13
B. Methodology	13
V. Reconciling Mechanism – Pensions and OPEBs	17
Schedules	22
Appendix A – Reference Materials	33

1 **Introduction and Summary**

2 **Q. Please state your name, current position and business address.**

3 A. My name is James J. Cunningham Jr. and I am employed by the New Hampshire
4 Public Utilities Commission (Commission) as a Utility Analyst. My business
5 address is 21 S. Fruit Street, Suite 10, Concord New Hampshire, 03301.

6 **Q. Please summarize your educational and professional background.**

7 A. I am a graduate of Bentley University, Waltham, Massachusetts, and I hold a
8 Bachelor of Science-Accounting Degree. I joined the Commission in 1988. In
9 1995, I completed the NARUC Annual Regulatory Studies Program and
10 Michigan State University, sponsored by the National Association of Regulatory
11 Utility Commissioners. In 1998 I completed the Depreciation Studies Program,
12 sponsored by the Society of Depreciation Professionals, Washington, D.C., of
13 which I am a member. I have reviewed and provided direct testimony on a
14 variety of topics pertaining to New Hampshire electric, natural gas, steam, and
15 water utilities. In 2008, I was promoted to my current position of Utility Analyst
16 IV.

17 Prior to joining the Commission I was employed by the General Electric
18 Company (GE). While at GE, I completed the Financial Management Training
19 Program and held assignments in General Accounting, Government Accounting
20 & Contracts and Financial Analysis.

21 **Q. What is the purpose of your testimony?**

22 A. The purpose of my testimony is to provide my recommendations pertaining to
23 amounts proposed by Granite State Electric Company (GSEC) for the following

1 items: depreciation and amortization, depreciation related rate base adjustments,
2 and employee pensions and benefits expenses including amortization of New
3 England Electric System (NEES) and Liberty acquisition-related deferred
4 amounts. In addition, my testimony provides a recommendation on GSEC's
5 proposal for an annual pension and OPEB mechanism.

6 **Q. Please summarize your recommendations pertaining to each of these items.**

7 A. I recommend a reduction of \$2,243,286 to the proposed amount of \$5,522,706 for
8 depreciation and amortization. Also, I recommend a depreciation-related rate
9 base adjustment that increases rate base by a net effect of \$233,077. In addition, I
10 recommend a reduction of \$621,065 to the proposed amount of \$2,214,945 for
11 employee pensions and benefits expenses. Finally, I recommend a reduction of
12 \$636,554 to the proposed amount for amortization of NEES and Liberty
13 acquisition-related deferred amounts. See Schedule JJC-1 for a summary of these
14 recommendations.

15 **Q. Are your recommendations reflected in the testimonies of other Staff**
16 **witnesses?**

17
18 A. Yes.

19

20 **Depreciation and Amortization**

21 **Q. Please summarize the depreciation expense that is proposed by GSEC.**

22 A. GSEC proposes four adjustments to test year 2012 depreciation expense. The
23 first adjustment increases test year depreciation expense by \$89,056.¹ This
24 adjustment reflects plant in service at the end of the test year, *i.e.*, December 31,

¹ Reference Filing, RR3-11 (CU), line 30.

1 2012. The second adjustment increases depreciation expense by \$35,521.² This
2 adjustment reflects the new proposed depreciation accrual rates based on the new
3 depreciation study prepared by Mr. Watson. The third adjustment increases
4 depreciation expense by \$214,938.³ This adjustment pertains to depreciation
5 adjustments for capital additions to March 31, 2013, and for Construction-Work-
6 In-Progress (CWIP) items that were closed out to individual plant accounts at
7 December 31, 2012. The final adjustment pertains to amortization of depreciation
8 reserve imbalances. This adjustment increases depreciation expense by
9 \$316,017⁴ and is caused by the impact of different depreciation accrual rates –
10 i.e., new depreciation accrual rates proposed by Mr. Watson versus the existing
11 Commission approved depreciation accrual rates. In summary, GSEC’s proposed
12 depreciation expense is \$5,522,706. See Schedule JJC-2 for a summary of these
13 adjustments.

14 **Q. Please provide a summary of your recommended depreciation expense.**

15 A. There are three components to my depreciation expense analysis: analysis of
16 average service lives (ASL); analysis of net salvage rates; and, analysis of prior
17 accumulated depreciation reserves.

18 With respect to average services lives, my recommendation adopts most of the
19 average service lives proposed by Mr. Watson. I explain my recommendations by
20 plant account later in my testimony. See attached Schedule JJC-7 for a
21 comparison of average service lives – i.e., existing, proposed and recommended.

² Reference Filing, RR-3-11 (CU), line 31; and, the Depreciation Study performed by Dane Watson.

³ Reference Filing, RR-3-11, line 34.

⁴ Reference Filing, RR-3-12, line 28.

1 With respect to net salvage⁵, historical data was provided with the depreciation
2 study and it indicates the cost of removal is increasing⁶ and net salvage rates are
3 becoming more negative – i.e., the cost to remove and dispose of the asset is
4 greater than the scrap value that is received when the asset is retired. The
5 depreciation study proposes a significant increase in negative net salvage for both
6 distribution and general plant accounts. My analysis recommends increases, as
7 compared to existing net salvage rates, but not as much as proposed by Mr.
8 Watson. I will explain my recommendations by plant account later in my
9 testimony. See attached Schedule JJC-8 for a comparison of net salvage
10 percentages – i.e., existing, proposed and recommended.

11 The final component of the depreciation expense analysis pertains to prior
12 accumulated depreciation reserves. To the extent that the prior depreciation
13 reserve balances are different from my analysis, the difference or imbalance is
14 amortized over a short period of time.⁷ I will provide more details on this
15 amortization by plant account later in my testimony.

⁵ Mr. Watson provides the following definition of net salvage: “...net salvage is the difference between the gross salvage (what is received in scrap value for the asset when retired) and the removal cost (cost to remove and dispose of the asset). Salvage and removal cost percentages are calculated by dividing the current cost of salvage or removal by the original installed cost of the asset.” (Testimony of Dane Watson, page 11 of 18, lines 2-6)

⁶ Reference the depreciation study performed by Dane Watson, Appendix E (Bates 77-82).

⁷ Source: NARUC’s Public Utility Depreciation Practices Manual, August 1996, page 189, states: “The use of an annual amortization over a short period of time or the setting of depreciation accrual rates using the remaining life technique are two of the most common options for eliminating the imbalance.” Since the Commission does not use the remaining life technique for setting depreciation accrual rates, I’m recommending amortization over a short period of time – i.e., 5 years.

1 In summary, my analysis results in a recommendation for depreciation expense
2 that is \$3,279,420, a reduction of \$2,243,286 from the proposed amount of
3 \$5,522,706. See attached Schedule JJC-3 for a summary.

4 **Q. Please explain what technique you utilized in your depreciation analysis.**

5 A. My testimony utilizes the whole-life (WL) technique; and, I utilized depreciable
6 plant balances as of December 31, 2012 as the basis for calculating depreciation
7 expense.⁸ The whole-life technique is consistent with the Commission's practice
8 for setting depreciation accrual rates for other electric utilities, as well as for
9 natural gas and water utilities. This technique is consistent with the technique
10 utilized by Mr. Watson in his depreciation study in this case. The WL formula
11 used to calculate depreciation accrual rates is as follows:

$$\text{WL Depreciation Accrual Rate} = \frac{100\% - \text{Net Salvage Percent (NSP)}}{\text{Average Service Life (ASL)}}$$

12
13
14
15
16
17 To illustrate, if we assume an average service life of 10 years and a net salvage
18 Rate of negative 20 percent, the whole-life depreciation accrual rate is calculated
19 at 12 percent, as follows: $[100\% - (-20\%)] / 10 = 12\%$.

20 See attached Schedule JJC-4 for the depreciation accrual rates that I recommend
21 for each individual plant account based on the WL technique.

22 **Q. How did you determine your recommended average service lives by**
23 **individual plant account?**

24
25 A. For the vast majority of plant accounts, I'm recommending the same average
26 service lives that are proposed in Mr. Watson's depreciation study; however, for

⁸ Note: Plant Balances at December 31, 2011 were used for the Depreciation Reserve Variance analysis in order to be consistent with the analysis that was performed by Mr. Watson (ref. the testimony and depreciation study performed by Mr. Watson, page 52 of 58).

1 several plant accounts I recommend life extensions as noted below. See Schedule
2 JJC-7 for a comparison, by plant account, of proposed and recommended average
3 service lives. Also, I'm using the same Simulated Plant Record-Balance (SPR-
4 BAL) methodology used by Mr. Watson.⁹ For several plant accounts, I modified
5 Mr. Watson's recommendations as follows:

6 Plant Account 362 – Station Equipment: The existing Commission approved
7 average service life is 35 years. Mr. Watson is recommending a 4-year life
8 extension to 39 years. I'm recommending a slightly higher average service life of
9 41 years. My recommendation is based on Mr. Watson's Simulated Plant
10 Record-Balance (SPR-BAL) analysis, the details of which reveal that the 41-year
11 average service life has a good Conformance Index (CI)¹⁰ and an excellent
12 Retirement Experience Index (REI).¹¹

13 Plant Account 364 – Poles Towers and Fixtures: The existing Commission
14 approved average service life is 25 years. Mr. Watson is recommending a 10-year
15 life extension to 35 years. I'm recommending an average service life of 40 years.
16 The SPR-BAL analysis indicates an average service life of 56 years, with a fair CI
17 and an excellent REI. However, as stated by Mr. Watson, company personnel

⁹ The Depreciation Study performed by Dane Watson, provides a brief description of the SPR-BAL methodology at page 6. An excerpt is as follows: *“In this method, an Iowa Curve and average service life are selected as a starting point of the analysis and its survivor factors applied to the actual annual additions to give a sequence of annual balance totals. These simulated balances are compared with actual balances by using both graphical and statistical analysis. Through multiple comparisons, the mortality characteristics (as defined by an average life and Iowa Curve) that are the best match to the property in the account can be found.”* (page 9 of 58).

¹⁰ The rating scale for the Conformance Index (CI) is defined by Mr. Watson in his Depreciation Study as follows: *CI rating over 75 is Excellent, 50 to 75 is Good, 25 to 50 is Fair and Under 25 is Poor* (page 10 of 58).

¹¹ The rating scale for the Retirement Experience Index (REI) is defined by Mr. Watson as follows: *REI rating over 75 is Excellent, 50 to 75 is Good, 35 to 50 is Fair, 17-33 is Poor and under 17 is Valueless”* (page 11 of 58).

1 state that “a life of less than 40 years as being reasonable”.¹² Taking into account
2 the SPR-BAL analysis along with the statements of company personnel, my
3 recommendation is that an average service life of 40 years is reasonable.

4 Plant Account 366 – Underground Conduits: The existing Commission approved
5 average service life is 60 years. Mr. Watson is recommending a 10-year
6 acceleration to 50 years. I’m recommending an acceleration of 5 years to 55
7 years. The SPR-BAL analysis indicates an average service life of 41 years;
8 however, the Commission-approved average services life for underground
9 conduits for another NH electric utility, Unitil Energy Systems, Inc. is 56 years.
10 Based on the above, I believe a shortening of the existing 60-year average service
11 life is appropriate; however, I believe the proposed 10-year acceleration is too
12 much. I recommend a 5-year acceleration.

13 Laboratory Equipment: The existing Commission approved average service life
14 is 25 years. Mr. Watson is recommending no change. I’m recommending an
15 average service life of 33 years. My recommendation is consistent with the SPR-
16 BAL analysis which indicates an average service life of 33 years, showing a good
17 CI and excellent REI.

18 Communication Equipment: The existing Commission approved average service
19 life is 25 years. Mr. Watson is recommending a 5-year acceleration to 20 years.
20 I’m recommending an average service life of 22 years. My recommendation is
21 consistent with the SPR-BAL analysis which indicates an average service life of
22 22 years, showing a fair CI and excellent REI.

¹² Source: Mr. Watson’s Testimony, Attachment DAW-2, page 24 of 58.

1 **Q. Please continue by explaining your recommendation with respect to net**
2 **salvage.**

3
4 A. My recommendation with respect to net salvage is based, in part, on available
5 historical data and in part on judgment.¹³ This data covers the 8-year period
6 2004 to 2011 and was available by plant account. The same data was used by Mr.
7 Watson in his depreciation study. It's important to note that historical data, prior
8 to 2004, was not available by plant account. The Company's accounting system
9 did not maintain net salvage data on a plant account basis prior to 2004; rather,
10 the Company's accounting system maintained net salvage data only on a
11 functional basis.¹⁴ See Schedule JJC-8 for a comparison of net salvage
12 percentages, by plant account, for the proposal versus Staff recommendation.

13 **Q. Do the proposed negative net salvage percentages represent a significant**
14 **increase, as compared to existing negative net salvage percentages?**

15
16 A. Yes. For distribution plant accounts, the depreciation study proposes significant
17 increases, as compared to the existing net salvage percentages. See Schedule JJC-
18 8 for a comparison, by plant account, of proposed and recommended net salvage
19 percentages. Several examples are as follows: the proposed net salvage for Plant
20 Account 364, Poles, Towers and Fixtures, is negative 50 percent, as compared to
21 the existing net salvage percent of negative 10 percent. The proposed net salvage
22 percentage for Plant Account 365, Overhead Conductors and Devices, is negative
23 45 percent, as compared to the existing net salvage percent of only negative 10
24 percent. The proposed net salvage percentage for Plant Account 369, Line

¹³ Source: Depreciation Study, page 12 of 58.

¹⁴ Source: Testimony of Dane Watson, page 14 of 18, lines 10-11.

1 Transformers, is negative 50 percent, as compared to the existing net salvage of
2 negative 10 percent.

3 For general plant accounts, Plant Account 390, Structures and Improvements, the
4 depreciation study proposes net salvage of negative 20 percent, as compared to
5 the existing net salvage percent of positive 5 percent, a 25 percentage point
6 increase.

7 **Q. Given the significant increases proposed for negative net salvage, coupled**
8 **with the limited historical data by plant account, what is your**
9 **recommendation?**

10
11 Based on the significant change and the limited historical data to support the
12 changes, I recommend that, for most distribution plant accounts, the proposed
13 increases in negative net salvage rates should be spread over two depreciation
14 study cycles, rather than incorporated entirely at this time. This has the benefit of
15 smoothing out the significant increase. Also, it has the benefit that, when the next
16 depreciation study is performed, in five years or so, more historical data will be
17 available to better inform the estimate of net salvage. For the remaining
18 distribution plant accounts, there is very little retirement activity; hence, I
19 recommend the same negative net salvage rates as proposed by Mr. Watson.

20 With respect to general plant accounts, my recommendation reflects the same net
21 salvage rates that are proposed by Mr. Watson with one exception – i.e., Plant
22 Account 390, Structures and Improvements. For this account, Mr. Watson is
23 proposing a significant increase, from positive 5 percent to negative 20 percent, a
24 25 percent increase. I recommend that the significant increase be spread over two
25 depreciation study cycles, rather than incorporated entirely at this time. For the

1 purpose of this proceeding, I recommend net salvage of negative 7.5 percent, a
2 12.5 percentage point increase.

3 **Q. Please explain your analysis pertaining to prior accumulated depreciation**
4 **reserves.**

5
6 A. My analysis shows that GSEC has accumulated a surplus in depreciation reserves
7 over 18 years, since the last depreciation study was performed in 1995.¹⁵ This
8 surplus was created primarily because booked depreciation accrual rates were
9 higher than my analysis current shows they should have been.

10 Booked depreciation reserves amount to \$55,931,380, as of December 31, 2011.¹⁶
11 However, based on my analysis, depreciation reserves should have been only
12 \$50,352,948. I recommend that this difference, \$5,578,432, should be amortized
13 over 5 years,¹⁷ or \$1,115,686 per year. See attached Schedule JJC-5 for the
14 derivation of my recommended amortization by individual plant account.

15 **Q. What were the results of GSEC's analysis of accumulated depreciation**
16 **reserves and how do those results compare to yours?**

17
18 A. GSEC's analysis of accumulated depreciation reserves are presented in the
19 Depreciation Study performed by Mr. Watson, at page 52 of 58 (Bates 0076). Mr.
20 Watson calculates a deficit of \$3,160,175, when compared to the booked
21 amounts. My analysis is presented on Schedule JJC-5. I calculate a surplus
22 \$5,578,432. The following table summarizes the differences in accumulated
23 depreciation reserves and the related amortization amounts.

24
25
26

¹⁵ Docket No. DE 95-169.

¹⁶ Source: Depreciation Study performed by Dane Watson, Attachment DAW-2, page 52 of 58.

¹⁷ By comparison, GSEC proposes a 10-year term for amortization.

Table 1
Calculation of Accumulated Depreciation Reserves
And Related Amortization Amounts

	<u>GSEC</u>	<u>Staff</u>
	<u>Proposed</u>	<u>Recommend</u>
Booked Amount	\$55,931,380	\$ 55,931,380
Calculated Amount	<u>\$59,091,555</u>	<u>\$ 50,352,948</u>
Deficit / (Surplus)	<u>\$ 3,160,175</u>	<u>\$ (5,578,432)</u>
Amortization Term	10 years	5 years
Amortization Amount	<u>\$ 316,175</u>	<u>\$ (1,115,686)</u>

Q. Please explain why your calculation of accumulated depreciation reserves differs from Mr. Watson’s calculation.

A. My calculation of accumulated depreciation reserves differs from Mr. Watson’s because my recommended depreciation accrual rates are different from Mr. Watson’s. Specifically, I’m recommending lower depreciation accrual rates than are proposed by Mr. Watson; thus, my calculation of accumulated depreciation reserves is lower than Mr. Watson’s calculation.

Q. Please summarize your overall recommendation for depreciation expense and related amortization of depreciation reserve variances.

A. I recommend \$3,279,420 for overall depreciation and amortization, a reduction of \$2,243,286 from the proposed level of \$5,522,706. See attached Schedule JJC-3.

Q. Do you have any other comments pertaining to depreciation expense?

A. Yes. For purposes of clarity, my analysis provides several reconciliations pertaining to plant balances. Schedule JJC-4A provides a reconciliation of the initial proposed plant balances and the updated plant balances, including construction work in progress (CWIP) that was closed to plant as of December 31, 2012. Schedule JJC-4B provides a reconciliation of plant balances in the filing

1 and plant balances in Staff's schedules, including footnote references to identify
2 the sources of the data.

3

4 **Depreciation-Related Rate Base Adjustments**

5 **Q. Please explain any depreciation-related rate base adjustments.**

6 A. I recommend two depreciation-related rate base adjustments. The first rate base
7 adjustment pertains to depreciation expense. Specifically, I'm recommending a
8 reduction to depreciation expense of \$2,243,286 from the amount proposed. A
9 reduction to depreciation expense results in a reduction to depreciation reserves,
10 which, in turn, results an increase to rate base. I'm estimating an increase in rate
11 base utilizing a half-year convention, or \$1,121,643.

12 The second adjustment pertains to deferred tax credits arising from liberalized
13 depreciation. When comparing tax depreciation to book depreciation, there is a
14 gap between the two amounts. The gap between tax and book depreciation gives
15 rise to a deferred income tax credit which, in turn, reduces rate base. Since my
16 recommendation for booked depreciation is reduced by \$2,243,286, the gap is
17 widened. This gap amount, when multiplied by the combined federal and state
18 income tax rate of 39.61 percent, results in an increase to deferred tax credits
19 which, in turn, reduces rate base by \$888,566 (i.e. \$2,243,286 x 39.61 percent).
20 In summary, the combination of both adjustments increases rate base by \$233,077
21 (i.e., \$1,121,643 less \$888,566). See attached Schedule JJC-6 for a summary of
22 my calculations.

23

1 **Employee Benefits and Expenses**

2 **Q. What is your recommendation for employee benefits expenses?**

3 A. I recommend \$1,593,880 for Account 926-Employee Benefits and Expenses, a
4 reduction of \$621,065 from the proposed amount of \$2,214,945. I recommend a
5 credit amortization of \$355,353 for the NEES' Acquisition Deferred (Credit), a
6 reduction of \$39,869 from the proposed credit amount of \$395,222. Finally, I
7 recommend \$1,442,447 for GSEC's Acquisition Deferred (Debit), a reduction of
8 \$676,423 from the proposed amount of \$2,118,870. See Schedule JJC-1 for a
9 summary. Also, see Schedule JJC-9 for additional details.

10 **Q. Please explain your recommended reduction to the amount proposed for**
11 **Account 926 – Employee Benefits and Expenses.**

12
13 A. There are a number of components included in Account 926 – Employee Benefits
14 and Expenses as follows:

- 15 • Pensions
- 16 • Other Post-Employment Benefits (OPEBs)
- 17 • 401K (Thrift Plan)
- 18 • Workers Compensation
- 19 • Medical Expense
- 20 • Other Health Care
- 21 • Inactive Employees

22
23 Pensions: My recommendation for pensions is \$424,822, a reduction of \$178,760
24 from the proposed amount of \$603,582. I adopt the amount estimated by the
25 Cottonwood Group, the firm hired by GSEC to perform an actuarial study of
26 GSEC pension expenses, with one modification. I recommend a 25 basis point
27 increase in the return on plan assets, or \$45,580.¹⁸ In addition, I note that that the

¹⁸ Reference Appendix A, response to Staff 6-2 and Staff 7-2 (attached). These responses indicate that, based on updated assumptions, released in early 2013, the long-term rate of return

1 Cottonwood Group provided an actuarially determined pension amount for each
2 employee in 2012 and 2013.¹⁹ This pension amount appears to include new hires
3 in 2013. Therefore, to avoid duplication, I have not added a separate amount for
4 pension expense for 2013 new hires. See Schedule JJC-9 for a summary of my
5 recommendation.

6 OPEBs: My recommendation for OPEBs is \$248,019, a reduction of \$102,922
7 from the proposed amount of \$350,941. It represents the amount estimated by the
8 Cottonwood Group, the firm hired by GSEC to perform an actuarial study of
9 GSEC OPEB expenses, with one modification. I recommend a 25 basis point
10 increase in the return on plan assets, which reduces OPEB expense by \$18,400.²⁰

11 In addition, I note that that the Cottonwood Group provided an actuarially
12 determined OPEB amount for each employee in 2012 and 2013. This OPEB
13 amount appears to include new hires in 2013.²¹ Therefore, to avoid duplication, I
14 have not added a separate amount for OPEB expense for 2013 new hires. See
15 Schedule JJC-9 for a summary of my recommendation.

16 401K Thrift Plan: My recommendation for 401K (Thrift Plan) expense is
17 \$167,037, a reduction of \$32,641 from the proposed amount of \$199,678. It is
18 based on the actual 2012 test year amount²² and is adjusted for estimated capital
19 bill-out amounts and estimated amounts for 2013 new hires. My estimate for

would be 5.79, a 29 basis point increase over the assumption used in the original actuarial study (Staff 6-2). Further, in response to Staff 7-2, GSEC indicates that the impact of a 25 basis point increase in the long-term rate of return would result in a decrease in the 2013 pension expense of \$45,580.

¹⁹ Reference Appendix A, response to Staff 3-55 (attached).

²⁰ Reference Appendix A, response to Staff 7-1 (attached).

²¹ Reference Appendix A, response to Staff 3-55 (attached).

²² Reference Appendix A, response to discovery, Staff 6-5 (attached).

1 2013 new hires is based on the proposed amount, reduced by 20 percent to reflect
2 the expectation that there will now be 4 fewer new hires in 2013 than originally
3 proposed.²³ See Schedule JJC-9 for a summary of my recommendation.

4 Workers Compensation: My recommendation for workers compensation is
5 \$64,165, a reduction of \$126,477 from the proposed amount of \$190,642. It is
6 based on 25 percent of the two-year average of Workers Compensation expenses
7 for 2011 and 2012, and it is adjusted for estimated capital bill-out amounts and
8 estimated amounts for 2013 new hires, reflecting 4 fewer new hires than
9 originally proposed. GSEC advised in discovery that Workers Compensation
10 expense was approximately \$150,953, on average, for 2011 and 2012; but, these
11 expenses were recorded primarily in FERC Account 925, Injuries and Damages
12 (not Account 925 – Employee Benefits and Expenses).²⁴ Based on this response,
13 I’m not certain what GSEC means by “primarily”; but, rather than provide zero
14 expense, due to uncertainty, I have used a conservative estimate for the level of
15 expense of \$37,738 (i.e., 25 percent of \$150,953). See Schedule JJC-9 for a
16 summary of my recommendation.

17 Medical Expenses: My recommendation for medical expense is \$519,478, a
18 reduction of \$80,158 from the proposed amount of \$599,636. It is based on the
19 actual 2012 test year costs, adjusted for medical cost trends of 7.5 percent for
20 2013 as utilized by Cottonwood Group in its actuarial report for OPEBs.²⁵ Also,
21 my recommended amount is adjusted for estimated capital bill-out amounts and

²³ Reference Appendix A, response to Staff 7-7 (attached).

²⁴ Reference Appendix A, response to Staff 7-5 (attached).

²⁵ Reference Appendix A, response to Staff 1-40(5), page 19 (extract attached).

1 estimated amounts for 2013 new hires, reflecting 4 fewer new hires than
2 originally proposed. See Schedule JJC-9 for a summary of my recommendation.
3 Other Health Care Costs: My recommendation for other health care costs is
4 \$42,225, a reduction of \$100,108 from the proposed amount of \$142,333. It is
5 based on the actual 2012 test year amount, adjusted for capital bill-out amounts
6 and estimated amounts for 2013 new hires, reflecting 4 fewer new hires than
7 originally proposed. See Schedule JJC-9 for a summary of my recommendation.
8 Inactive Employees: My recommendation adopts the same amount as proposed
9 by GSEC, \$128,133.²⁶
10 Amortization of NEES Acquisition Deferred Credit: My recommendation for
11 Amortization of NEES Acquisition Deferred Credit is \$355,353, a reduction of
12 \$39,869 from the proposed amount of Deferred Credit \$395,222. Since this
13 reduction is a credit, expenses increase by \$39,869. GSEC provided historical
14 data that was reported on a fiscal year basis – i.e., \$235,746 for fiscal year ending
15 March 31, 2013 and \$395,222 for fiscal year ending March 31, 2014. I converted
16 this fiscal year data into calendar year data – i.e., January through December
17 2013, for purposes of calculating my recommended amount.²⁷
18 Amortization of Liberty Acquisition Deferred Debit: I recommend \$1,442,447, a
19 reduction of \$676,423 from the proposed amount of \$2,118,870. My
20 recommendation amortizes the Liberty Acquisition Deferred Debit of
21 \$21,636,699 over a 15-year term, or \$1,442,447 per year (\$21,636,699 divided by

²⁶ Reference Appendix A, response to Staff 6-5.1 and TS 1-2 (attached). This response appears to allocate Inactive Employee expense to pension and OPEB components.

²⁷ Reference Appendix A, response to Staff 3-33 (attached).

1 15 years). My recommendation reflects a 5-year extension to the 10-year term of
2 amortization that was proposed by GSEC.

3 With respect to the term over which the Liberty Acquisition Deferred Debit
4 should be amortized, my recommendation is consistent with financial accounting
5 standards (FAS) 87, paragraph 77, which indicates that if the average remaining
6 service period of employees expected to receive benefits under the plan is less
7 than 15 years, then a straight line amortization of 15 years may be used.²⁸ Since
8 the average remaining service period of employees is 10.52 years,²⁹ the 15-year
9 amortization is reasonable. I note that my recommended 5-year extension is
10 conservative (i.e., slightly accelerated) when compared to the amortization term
11 being used by GSEC to amortize the NEES Acquisition Deferred Credit. In that
12 instance, the amortization term is approximately 18 years.³⁰

13
14 **Pension and OPEB's Mechanism**

15 **Q. GSEC is proposing a reconciliation mechanism for pensions and OPEB**
16 **expenses. Please summarize the proposal.**
17

²⁸ Reference Appendix A, response to Staff Tech 1-4 which reiterates FAS-87, paragraph 77 with respect to such acquisition amounts as follows: *“the difference (i.e., the Liberty Acquisition Deferred Debit)...shall be amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits under the plan (except) that, (a) if the average remaining service period is less than 15 years, the employer may elect to use a 15-year period...”*

²⁹ Reference Appendix A, response to Staff 6-8 (attached) which indicates that 10.52 years is the estimate of the average futures service years as provided by the Cottonwood Group actuarial study used in this instant case.

³⁰ Reference Appendix A, response to Staff 3-33 (attached). The NEES Acquisition Deferred Credit will be fully amortized in 18 years. Based on the balance at March 31, 2013 of \$1,231,330 and the 2012-2013 fiscal year amortization of \$235,746, the NEES Acquisition Credit will be fully amortized on March 31, 2018, a term of 18 years from the beginning balance established on March 22, 2000.

1 A. Under the proposal, the estimated 2013 rate year amount of \$3,938,594³¹ is
2 included in revenue requirements. At December 31 of each year, a deferred
3 account would be established for the difference between this amount and the
4 actual pension and OPEB expense for the year; and, any balance, positive or
5 negative, would be collected or refunded through a distribution adjustment charge
6 during the subsequent year.³²

7 **Q. Do you recommend that the Commission approve GSEC's proposal for a**
8 **pension and OPEB mechanism for GSEC?**

9
10 A. No.

11 **Q. Please provide your reasons for not recommending an annual reconciling**
12 **mechanism.**

13
14 A. GSEC asserts that a mechanism is needed, in part, because of the following
15 reasons:

- 16 • Pension and OPEB expenses are large and that the Company's ability to
17 control these costs is very limited.³³
- 18 • Pension and OPEB cost is large and has significant volatility.³⁴
- 19 • GSEC's ability to affect the level of pension and OPEB benefits is
20 overshadowed by the Company's inability to control the key variables that
21 affect year-by-year benefit costs.³⁵

22
23 Limited Ability to control Pension and OPEB Expenses: I believe the company
24 has many ways it can exert control over pension and OPEB expense. In fact, in
25 discovery, GSEC has confirmed that it can exert control over pension and OPEB
26 expense:

³¹ This amount represents the update amount from RR-3-03 (CU), line 40.

³² Source: Testimony of Christiane G. Mason and DR. Michael R. Schmidt, page 49 of 63.

³³ Reference Filing, Testimony of ChristiAne Mason and Doctor Michael R Schmidt, page 49 of 63 (Bates 0055), line 15.

³⁴ Reference Filing, Testimony of ChristiAne Mason and Doctor Michael R Schmidt, page 51 of 63 (Bates 0054), line 15.

³⁵ Reference Filing, Testimony of ChristiAne Mason and Doctor Michael R Schmidt, page 50 of 63 (Bates 0053), lines 7-9.

1 going forward, will be smoothed out. Medical costs were down from 2011 by
2 \$138,635, from \$555,476 to \$416,841. This does not represent significant
3 volatility – i.e., as a percentage of overall Employee Pension and Benefit
4 expenses in 2012, this reduction is only 6.6 percent of the overall costs (i.e.,
5 \$138,635 divided by \$2,090,156).

6 With respect to 2012 to 2013 changes, based on the above Table, Employee
7 Benefits and Expenses are down \$104,877. My analysis indicates that this
8 variance pertains mostly to a reduction in Pensions and OPEB expenses. The
9 pension reduction appears to be the result of GSEC’s adoption of a cash balance
10 pension plan for new non-union employees, as noted above, in lieu of the more
11 costly traditional final average pay pension benefits that cover some legacy
12 employees. The OPEB reduction appears to be the result of GSEC’s action, as
13 noted above, to install a fully-insured, premium based structure with an insurance
14 company. Based on the above, I believe that GSEC has not made a persuasive
15 case for the need for a mechanism based on significant volatility.

16 Inability to control the key variables that affect year-by-year benefit costs: There
17 are a number of economic variables that are included in actuarial studies that
18 GSEC has performed each year which, in turn, are used to forecast and record
19 pension and OPEB expenses. Economic variables include estimated discount
20 rates, estimated long-term rates of return on plan assets, salary scales, and
21 inflation rates. According to discovery, the GSEC actuary, Cottonwood Group,
22 provided recommendations to GSEC Finance; and, GSEC, in turn, reviewed and
23 approved the recommendations of Cottonwood Group prior to the preparation of

1 the actuarial study.³⁸ Based on the above, I believe GSEC exercises some control
2 over these economic variables.

3 **Q. Do you have any other comments on the proposed reconciliation mechanism**
4 **for pensions and OPEB expenses?**

5
6 A. Yes. I believe that a reconciliation mechanism for pensions and OPEB expenses
7 should have an attendant impact on return on equity (ROE). Pension and OPEB
8 expenses represent a major component of expense in a rate case; and, by setting
9 up an annual reconciling mechanism, such mechanisms reduce GSEC's risk; and,
10 this reduction in risk should be mirrored in a reduction in the proposed ROE.

11 However, GSEC proposed no adjustment to reduce ROE.³⁹

12 Further, pension and OPEB expenses, as noted above, represent a major
13 component of expense. In the past three years, as noted above, GSEC has taken
14 several steps to control these pension and OPEB costs. Had an annual reconciling
15 mechanism been in place, GSEC would not have had the same incentive to
16 control these costs, in my view.

17 **Q. Does that complete your testimony?**

18 A. Yes, it does, thank you.

³⁸ Reference Appendix A, response to Staff 6-3 (attached).

³⁹ Reference Appendix A, response to Staff 6-15 (attached).