STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DOCKET DE 16-384

IN THE MATTER OF: UNITIL ENERGY SYSTEMS, INC.

REQUEST FOR CHANGE IN RATES

DIRECT TESTIMONY

OF

DONNA H. MULLINAX
CONSULTANT TO STAFF

NOVEMBER 16, 2016

Table of Contents

List of Attachments

Introduction and Summary

Q. Please state your full name?

A. My name is Donna Hubler Mullinax.

Q. By whom are you employed and what is your business address?

A. I am employed by Blue Ridge Consulting Services, Inc. My business address is 114 Knightsridge Road Travelers Rest, SC 29690.

Q. Please summarize your education and professional work experience.

A. I graduated with honors from Clemson University with a Bachelor of Science in Administrative Management and a Master of Science in Management. I am a Certified Public Accountant (CPA), Certified Internal Auditor (CIA), a Certified Financial Planner (CFP), and a Chartered Global Management Account (CGMA) designation holder. I am a member of the South Carolina Association of Certified Public Accountants, the American Institute of Certified Public Accountants, and the Institute of Internal Auditors.

I have over 37 years of professional experience and have been a utility industry consultant for the last 23 years. My consulting assignments include numerous rate cases for natural gas and electric utilities and litigation support for various construction claims. Other project experience includes management, financial, and compliance audits, due diligence reviews, prudence reviews, and economic viability and financial studies. I have worked with public service commissions, attorney generals, and public advocates in Arizona, Colorado, Connecticut, Delaware, District of Columbia, Hawaii, Illinois, Maryland, Massachusetts, Michigan, Missouri, Nebraska, New York, North Dakota, Ohio, Oregon, and Utah.

Q. Have you included a more detailed description of your qualifications?

A. Yes. A description of my qualifications is included as Attachment DHM-1.

Q. Have you previously testified before the New Hampshire Public Utilities Commission?

A. No.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Staff of the New Hampshire Public Utilities Commission ("Commission").

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

A. The purpose of my testimony is to address the revenue requirements and revenue deficiency proposed by Unitil Energy Systems, Inc. (UES or "Company") and to present the impact of Staff's recommended ratemaking adjustments on the Company's revenue deficiency.

Q. Please summarize your recommendations.

A. The following table summarizes Staff's recommendations regarding revenue requirements and revenue deficiency.

Table 1: Summary of Staff's Recommended Adjustments and the Impact on Rate Base, Operating Income, and Revenue Deficiency

Staff's Recommended Rate of Return	7.91%
Revenue Conversion Factor	1.65590

		Rate Base	Operating Income	Revenue Deficiency
Adjustment 1	Adjust Cash Working Capital for Expense Adjustments	$ (73,717)	$ -	$ (9,656)
Adjustment 2	Remove Prepayments Also Included in Cash Working Capital	(1,444,119)	-	(189,154)
Adjustment 3	Audit Issue #2 Kingston Substation Video - Non-Recurring Expense	-	11,213	(18,568)
Adjustment 4	Audit Issue #5 Below the Line Amounts Not Removed in Update	-	6,648	(11,008)
Adjustment 5	Eliminate Inflation Allowance for 2017 Expenses	-	82,572	(136,731)
Adjustment 6	Eliminate 2017 Wage Increase	-	159,775	(264,572)
Adjustment 7	Eliminate Increase to 401(k) Associated with 2017 Increase to Payroll	-	8,413	(13,930)
Adjustment 8	Eliminate 2017 Increase in Medical and Dental Insurance	-	66,911	(110,798)
Adjustment 9	Eliminate Restricted Stock Plan and EPS Component of Inc Comp	(450,844)	406,492	(732,164)
Adjustment 10	Eliminate 2017 Increase to Insurance Premiums	-	1,785	(2,956)
Adjustment 11	Modification to Property Taxes	-	259,767	(430,150)
Adjustment 12	Sharing of Directors and Officers Liability Insurance	(19,600)	7,817	(15,511)
Adjustment 13	Modifications to Depreciation and Amortization	43,350	26,179	(37,672)
Adjustment 14	True-Up Payroll Taxes for Other Adjustments	-	20,042	(33,188)
Adjustment 15	Interest Synchronization	-	(26,894)	44,534
	Impact of Staff's Recommended Cost of Service			(2,137,549)
		$ (1,944,931)	$ 1,030,720	$ (4,099,073)

Q. What revenue increase does Staff recommend?

A. Staff's recommends a base rate increase of no more than $2,485,637. The following table shows the Company's updated revenue deficiency request and Staff's recommendation.

Table 2: Staff's Recommended Revenue Deficiency

Company's Updated Revenue Deficiency	$ 6,584,710
Staff's Recommended Adjustment	(4,099,073)
Staff's Recommended Revenue Deficiency	$ 2,485,637

Q. Are you presenting any exhibits in connection with your direct testimony in this proceeding?

A. Yes. Besides my qualifications already mentioned as Attachment DHM-1, Attachment DHM-2 includes Staff's revenue requirements schedules, and Attachments DHM-3 through DHM-11 are copies of selected documents that are referenced in my testimony.

Q. How are Staff's revenue requirements schedules organized?

A. Staff's revenue requirements schedules, included in Attachment DHM-2, are organized into summary schedules and adjustment schedules. The schedules consist of Schedules 1, 1.1, 1.2, 2, 2.1, 3, 3.1 through 3.15.

Q. What is shown on Schedule 1?

A. Schedule 1 is a summary comparison of the Company's and Staff's computation of the revenue requirement and the revenue deficiency. The schedule summarizes the impact of all of Staff's recommendation adjustments and reflects revenue requirement needed for the Company to have the opportunity to earn Staff's recommended rate of return on Staff's proposed rate base.

Q. What is shown on Schedule 1.1?

A. Schedule 1.1 provides additional detail by major rate base and operating income categories and shows how Staff's recommended adjustments are applied to the Company's updated filings to obtain Staff's recommended revenue requirement and revenue deficiency.

Q. What is shown on Schedule 1.2?

A. Schedule 1.2 presents the calculation of the revenue conversion factor. The revenue conversion factor grosses up the Income Deficiency amount for income taxes to obtain the Revenue Deficiency amount. The conversion is needed to reflect that more than one dollar in gross revenue is needed for each dollar of net operating income because of the imposition of taxes on those earnings.

Q. What is shown on Schedules 2 and 2.1?

A. Schedule 2 summarizes the capital structure and cost of capital proposed by the Company and the capital structure and cost of capital recommended by Staff witness, J. Randall Woolridge. Schedule 2.1 isolates the impact on the revenue deficiency for the difference in the Company's proposed capital structure and cost of capital and that recommended by Staff.

Q. What is shown on Schedule 3 and Schedules 3.1 through 3.15?

A. Schedule 3 summarizes Staff's adjustments to rate base and operating income (i.e., revenues less expenses). Schedules 3.1 through 3.15 provide further support and calculations for the adjustments Staff is recommending.

Revenue Requirements

Q. What revenue increase has been requested by the Company?

A. The Company's Application requested an increase in base rate revenues of $6,255,276, which represents an increase of 12.1 percent over the Company's Test Year Distribution

Revenue under present rates.[1] On September 16, 2016, the Company filed an update to the revenue requirements. The Company's updated request is for an increase in base rates of $6,584,710, or an additional $329,434.[2]

Q. What was the Company's explanation for the increase in rates in its updated filing?

A. The Company's stated that four updates were made to its original filing:

1. All applicable NH PUC audit issues were accepted as indicated in the audit report. The Company noted that for audit issue 5, the Company only adjusted for donations for $150, because the Company continues to believe the other expenses are appropriate to treat above the line.
2. Corrections were made to depreciation rates as discussed during the September technical session. This update is reflected in rate base and depreciation expense.
3. The amounts for the Kingston substation were updated for the final amount of $10,336,281, as compared to the initial filing's preliminary estimate of $9,880,166.
4. An adjustment was made to reflect the latest NH PUC assessment. The Company collects the PUC assessment in both base rates and through its External Delivery Charge (EDC) mechanism. The Company proposes to move all recovery to base rates, with any subsequent incremental changes flowing through the EDC mechanism. The Company stated that adjustment is necessary to comply with the requirements of RSA 363-A:6,1. The adjustment is significant but does not reflect any additional impact to ratepayers or additional revenue to the Company.[3]

---

[1] Test Year Distribution Revenue $51,600,877 per Schedule RevReq-2.
[2] UES Filing dated September 6, 2016, Schedule RevReq-1.
[3] UES Filing dated September 6, 2016, cover letter.

Q. Did the Company indicate that additional updates will be provided for its requested revenue increase?

A. Yes, in its September 16, 2016 update, the Company stated that it plans to "make further updates to the revenue requirements before the completion of this proceeding to reflect final 2017 payroll, final 2017 medical and dental working rates, property and liability insurances renewing before May 1, 2017, and final property tax bills for 2016."[4]

Q. When was the Company's current Distribution revenue requirement established?

A. UES's current rates were established in Order No. 25,214 (April 26, 2011), based on a test year ending December 31, 2009, with rates effective on May 1, 2011. The current rates were the result of a Settlement, resulting in an increase in distribution revenues of $4,991,314. The rate change represented an increase of 3.3 percent of total revenues, or 12.3 percent of distribution revenues. The rate change was followed by three additional step adjustments that were implemented on May 1, 2012 (an increase of $1,509,376), May 1, 2013 (an increase of $1,865,624), and May 1, 2014 (an increase of $1,430,828).[5]

Test Year

Q. What test year is being used in this case?

A. The Company has based its request for a revenue increase on a historical test year of the 12 months ended December 31, 2015.[6] Staff's calculations use the same historical test year.

Q. Did the Company make adjustments to its historical test year?

---

[4] UES Filing dated September 6, 2016, cover letter.
[5] DE 10-055, Order No. 25,214, page 5.
[6] UES Direct Testimony of David L. Chong, page 5, line 12.

A. Yes, the Company stated that it used the "per books" data adjusted for known and measurable changes to revenues and expenses, or upon changes that will become known and measureable during the course of the proceeding.[7]

Adjustments Beyond One Year Past the End of the Test Year

Q. Has the Company included adjustments that are beyond one year past the end of the test year?

A. Yes. The Company stated that it limited all pro forma adjustments to those that will be known and measureable through May 1, 2017, which is the date permanent rates are expected to go into effect for this proceeding.[8] A review of the Company's ratemaking adjustments show numerous adjustments for 2017 that are beyond twelve months past the end of the test year. As will be discussed later, Staff has removed these adjustments as many are not known and measureable and are a departure from past Commission practice which is to use a historical average test year and avoid the use of extensive adjustments to operating results beyond twelve months after the end of the test year as discussed in the testimony of James J. Cunningham. Staff has limited adjustment to those that are known and measureable and within one year past the end of the test year.

Q. What is the Company's reasoning for adjusting its historical test year to include costs beyond twelve months past the end of the test year?

A. The Company's reasoning to include these future costs is to address earnings attrition. The Company states that

---

[7] UES Direct Testimony of David L. Chong, page 5, lines 5-6.
[8] UES Direct Testimony of David L. Chong, page 5, lines 14-19.

> "Without known and measurable adjustments extending through the pendency of this proceeding, the Company will experience earnings attrition and immediately under-earn coming out of this rate case. Mr. Collin presented testimony on earnings attrition at pages 9-14 of 28. Mr. Collin notes that earnings attrition occurs when a utility's cost rise faster than its revenues over time. Unitil Energy's revenues and costs are no longer matched. Since the last rate case in 2010, Unitil Energy's unit sales have been essentially flat while its rate base has grown form $130.8 mm to $153.0 mm."[9]

In addition, the Company stated that its rate base is growing at an annual growth rate of 3.0 percent.[10] The Company proposes various adjustments to the cost of service, which the Company states are "designed to offset attrition."[11] Most significant is the post-test year adjustment to rate base to reflect the $9.9 million addition to plant in service related to the Kingston Substation that went into service in April 2016.

Q. Does Staff support the Company's proposed adjustments to its revenue deficiency to address earnings attrition?

A. Staff is not opposed to the significant addition of the Kingston Substation into rate base as discussed in the testimony of Richard Chagnon. However, many of the Company's other adjustments are not known and measureable and extend more than a year past the end of the test year. Staff is recommending that these adjustments be disallowed. Each adjustment is discussed in the following sections.

[9] UES response to Staff 7-3 (Attachment DHM-3).
[10] UES Direct Testimony of Mark H. Collin, page 10, line 22-page 11, line 2.
[11] UES Direct Testimony of Mark H. Collin, page 12, lines 2-3.

Adjustments to Rate Base

Q. What rate base has the Company proposed?

A. The Company's updated rate base is $153,674,471.[12]

Q. Is Staff proposing any adjustments to the Company's proposed rate base?

A. Yes. Staff is recommending adjustments to the following rate base components:

- Cash Working Capital
- Prepayments
- Accumulated Depreciation and Amortization
- Capitalized Portion of the Restricted Stock Plan and EPS Component of Incentive Compensation
- Capitalized Portion of Directors and Officers Liability Insurance

Cash Working Capital

Q. Please explain Staff's recommended adjustment to Cash Working Capital.

A. Cash Working Capital is one of the Working Capital components of rate base. The Company's Cash Working Capital was developed through the preparation of a lead-lag study. The lead-lag is applied to each component of the cost of service to quantify the cash working capital requirement associated with that cost of service item. The cash working capital balance must be updated to reflect Staff's adjustments. Staff's adjustment is provided in Schedule 3.1.

[12] UES Schedule RevReq-1, updated September 16, 2016.

Prepayments

Q. Please explain Staff's recommended adjustment to Prepayments.

A. Like Cash Working Capital, Prepayments are another Working Capital component. The Company has included prepaid items for categories of expenses that are also included in its Cash Working Capital resulting an overstatement of rate base. By including both Prepayments and Cash Working Capital in rate base, the Company is requesting a double recovery of its return on these items. Staff's adjustment removes the Prepayments from rate base to eliminate the double count. The adjustment is shown on Schedule 3.2.

Q. Please elaborate.

A. The Company has prepaid $7.6 million for items like property taxes, insurance, postage, and pension. By prepaying these items, as opposed to leaving the funds in cash until the expense is due to be paid, the Company is requesting the ratepayers pay a return of 8.75% on these balances. In today's interest rates, 8.75% is significantly more than the Company would earn if these funds were left in cash or even invested in a Treasury Bill which are earning significantly less than 1.0%. If allowed, this double recovery would be similar to the Company using the ratepayers as a bank and requesting a significant amount of interest for these prepaid funds. The difference in the return is significant enough to encourage the Company to prepay items without a legitimate business reason. Since the funds to pay property taxes, insurance, postage, and pension are a component of distribution expense and are included in Cash Working Capital, the Company is earning a return on the lead of these payments. Including both Cash Working Capital and Prepayments in rate base means the ratepayers are paying a return on the same items twice.

Q. Is Staff's recommendation to exclude Prepayments from rate base consistent with sound ratemaking principles.

A. Yes. Staff's recommendation is supported by *Accounting for Public Utilities.*

> "For ratemaking purposes, working capital is a measure of the amount of funding needed to satisfy the level of the daily operating expenditures and a variety of non-plant investments that are necessary to sustain the on-going operations of the utility. The ratemaking measure of working capital is designed to identify these ongoing average funding requirements over a test period. Regulatory commissions vary as to the identification of individual components of working capital; however, in general, the components are: (1) fuel inventory; (2) materials and supplies (M&S); (3) prepayments; and (4) cash working capital."[13]
>
> -------
>
> "Prepayments as a component of working capital represents an investment of funds that are generally included in the rate base <u>if that investment has not been recognized elsewhere, such as in Cash Working Capital</u>" [emphasis added].[14]
>
> -------
>
> "If the usual definition of total working capital…is accepted, the important criterion is that the total of all components of working capital equal that definition. Therefore, if a commission chooses to use the typical working capital components (materials and supplies, inventories, fuel inventories, and prepayments), cash working capital will have a different meaning than if accrued taxes or other offsets to working capital are identified as separate components of total working capital."[15]

The referenced source continues

> "If the rate base is to be correctly measured, the cash working capital component must be compatible with the other rate base components. If

[13] Robert L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities* (LexisNexis, Release 32, December 2015), page 5-1-5-2 (Attachment DHM-6).
[14] Robert L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities* (LexisNexis, Release 32, December 2015), page 5-3 (Attachment DHM-6).
[15] Robert L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities* (LexisNexis, Release 32, December 2015), page 5-4 (Attachment DHM-6).

this principle is not recognized and applied, the rate base will not function as intended."[16]

Q. What amounts did the Company include in Prepayments?

A. The Company is requesting to include the following prepayments items in rate base.

Table 3: Prepayments Included Within Rate Base[17]

Prepayments		
Insurance:		
Prepaid Property Insurance	$	17,768
Prepaid Injuries and Damages Insurance		24,083
Prepaid Property Insurance-Capital		2,257
Prepaid Workers' Comp. Insurance-Capital		8,463
Prepaid Property Insurance-Seacoasst		3,010
Prepaid Worker's Comp. Insurance-Seacosts		9,483
Subtotal Insurance		65,064
Prepaid Property Tax		1,293,561
Prepaid Postage		67,244
Prepaid Line Maintenance		18,250
Prepaid Relvolver		15,027
FASB 87-Prepaid Pension		6,157,314
		7,616,460

Q. Does Cash Working Capital also include these categories of expenses?

A. Yes. The Company's Cash Working Capital is calculated based on adjusted operating expenses. Most of the categories of prepayments in the table above are operating expenses. For example, the Company has included $313,896[18] for insurance under the category A&G expenses. Property taxes totaling $6,059,709[19] are included in Taxes Other Than Income. Postage and line maintenance are typical expenses that would also be included in operating income. The only items that could be legitimate prepayments are: FASB 87-Prepaid Pension and Prepaid Revolver that likely are required prepayments. Staff has not excluded FASB 87-

[16] Robert L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities* (LexisNexis, Release 32, December 2015), page 5-4 (Attachment DHM-6).
[17] Commission Audit of UES dated August 5, 2016, page 12 (Attachment DHM-7).
[18] UES Schedule RevReq-3-4, line 1, updated September 16, 2016.
[19] UES Schedule RevReq-3-10 lines 37 and 38, updated September 16, 2016.

Prepaid Pension and Prepaid Revolver from rate base. The other Prepayments have been excluded in Staff's recommended adjustment.

Accumulated Depreciation and Amortization

Q. Please explain Staff's recommended adjustment to Accumulated Depreciation and Amortization.

A. Staff's adjustment to Accumulated Depreciation and Amortization recognizes the offsetting impact to rate base for Staff's adjustment to expenses for the Modifications to Depreciation and Amortization recommended by Staff witness James J. Cunningham. The adjustment is shown on Schedule 3.13.

Capitalized Portion of the Restricted Stock Plan and EPS Component of Incentive Compensation

Q. Please explain Staff's recommended adjustment for the Capitalized Portion of the Restricted Stock Plan and EPS Component of Incentive Compensation.

A. Staff's adjustment for the capitalized components of the Restricted Stock Plan and Incentive Compensation removes the capitalized portion of these expense items that the Company has allocated to its rate base. The adjustment is discussed later in my testimony and is shown on Schedule 3.9.

Capitalized Portion of Directors and Officers Liability Insurance

Q. Please explain Staff's recommended adjustment for Directors and Officers Liability Insurance.

A. Staff's adjustment for Directors and Officers Liability Insurance removes the capitalized portion of this expense that the Company has allocated to its rate base. The adjustment is discussed later in my testimony and is shown on Schedule 3.12.

Q. What is the impact of Staff's recommended adjustments to the Company's updated rate base?

A. The Company updated requested rate base was $153,674,471. Staff's recommended adjustments reduces the rate base to $151,729,540.

<u>Adjustments to Operating Income</u>

Q. What net operating income has the Company proposed?

A. The Company's updated operating income is $9,470,010.[20]

Q. Is Staff proposing any adjustments to the Company's proposed net operating income?

A. Yes. Staff is recommending adjustments to the following expense components:

- Audit Issue #2 Kingston Substation Video – non-recurring expense
- Audit Issue #5 Below the Line Amounts Not Removed in Update
- Eliminate Inflation Allowance for 2017 Expenses
- Eliminate 2017 Wage Increase
- Eliminate Increase to 401(k) Associated with 2017 Wage Increase
- Eliminate 2017 Increase in Medical and Dental Insurance
- Eliminate Restricted Stock Plan and EPS Component of Incentive Compensation

[20] UES Schedule RevReq-1, updated September 16, 2016.

- Eliminate 2017 Increase to Insurance Premiums
- Modification to Property Taxes
- Sharing of Directors and Officers Liability Insurance
- Modifications to Depreciation and Amortization
- True-Up Payroll Taxes for Other Adjustments
- Interest Synchronization

Audit Issue #2 Kingston Substation Video – Non-recurring Expense

Q. Please explain Staff's recommended adjustment: Audit Issue #2 Kingston Substation Video – non-recurring expense.

A. The Commission Audit identified costs in a capital project which provided no tangible benefit to the project or the customers of UES (Audit Issue #2). The costs were related to two videos detailing the construction of the Kingston Substation. The Audit recommended that the costs be removed from the capital account and booked to marketing expense. The costs were incurred over a three-year period and the Audit recommended that one-third of the costs be reclassified as an expense.[21] The Company concurred with the Audit recommendation and in its update moved $18,567 ($55,700/3 years) to Customer Communications (FERC 930).[22] While the Company reclassified the expenditure as an expense, it should not have included these costs in its revenue deficiency calculation. A construction progress video is unique and non-recurring. Staff adjustment removes the costs for the test year as unique and non-recurring. The adjustment is shown on Schedule 3.3.

[21] Commission Audit of UES dated August 5, 2016, page 81 (Attachment DHM-7).
[22] UES Schedule RevReq-3, updated September 16, 2016.

Audit Issue #5 Below the Line Amounts Not Removed in Update

Q. Please explain Staff's recommended adjustment: Audit Issue #5 Below the Line Amounts Not Removed in Update.

A. The Commission Audit reviewed approximately 106 O&M expenses and identified $11,159 in expenditures that the audit recommended should be booked below the line or not included in the cost of service for the purposes of establishing rates in this proceeding (Audit Issue #5).[23]

Q. Did the Company reduce its filing for these expenses?

A. No. The Company's updated filing only removed $150 for donations and stated in the cover letter to the update that "The Company noted that for audit issue 5, the Company only adjusted for donations of $150, because the Company continues to believe the other expenses are appropriate to treat above the line."[24]

Q. What is removed from the Company's revenue deficiency associated with Staff's adjustment for Audit Issue #4 Below the Line Amounts Not Removed in Update?

A. Staff's adjustment removes the remaining O&M expenses not moved below the line by the Company as recommended by the auditors. The adjustment is shown on Schedule 3.4.

Eliminate Inflation Allowance for 2017 Expenses

Q. Please explain Staff's recommended adjustment: Eliminate Inflation Allowance for 2017 Expenses.

---

[23] Commission Audit of UES dated August 5, 2016, page 86 (Attachment DHM-7).
[24] UES Filing dated September 6, 2016, cover letter.

A. UES has proposed an inflation adjustment that "increases 'residual O&M expenses' to recognize the general level of rising costs due to inflationary pressures." The Company used "the term 'residual O&M expense' to refer to such items as fuel for Unitil Energy's fleet of utility vehicles, professional fees such as actuarial, audit and legal services, office supplies, telecommunications expense, natural gas for heating, cleaning and building maintenance, snow removal and other contractor services." The Company stated that "it is not feasible to project specific adjustments for residual O&M expense that are comparable to adjustments made to other expense categories."[25] The Company's adjustment applies a 2.96% estimated inflationary factor to $4.8 million in "residual O&M expenses." These "residual O&M expenses" represent 23% of UES's total test year O&M expenses. The increases O&M expenses by $141,596.[26] Staff's adjustment removes the inflation adjustment as not known and measurable. The adjustment is shown on Schedule 3.5.

Q. Did the Company provide an explanation on why it is seeking escalated O&M costs beyond the end of the test period?

A. Yes. The Company argues that

> "All adjustments to the test year cost of service are based upon known and measurable changes to revenues and expenses, or upon changes that will become known and measurable during the course of this proceeding. As a practical matter, the Company has limited all pro forma adjustments to those that will be known and measurable through May 1, 2017, which is the date permanent rates are expected to go into effect for this proceeding."[27]

However, the Company's inflation adjustment is inconsistent with the Company's argument. An inflation adjustment beyond twelve months past the end of the test year is not known and

[25] Direct Testimony of David Chong, page 12, line 14 – page 13, line 2.
[26] Direct Testimony of David Chong, page 13, lines 14-15.
[27] Direct Testimony of David Chong, page 5, lines 14-19.

measureable. It is based on an estimate that has been applied to O&M expenses that may not be directly impacted by inflationary pressures even if the estimated inflation factor used by the Company turns out to be a good guess.

Q. Please explain why an inflation adjustment is not appropriate?

First, the Company used a historical test year with what it claims are "known and measureable" changes. Using an estimated inflation adjustment for "residual O&M expenses," along with the other adjustments for 2017, the Company has, in essence created a future test year. This goes against traditional "known and measureable" ratemaking practices. These estimated inflationary adjustments are not known and measureable. Second, applying a common inflation factor to all "residual O&M expenses" ignores other factors that can affect these residual costs. For example, fuel prices vary significantly by supply and demand. Legal costs are influenced by the actual legal issues that arise, not simple inflationary factors. Finally, arbitrarily applying an estimated inflation factor to 23% of UES's total test year O&M expenses removes the important responsibility of management to control costs.

Q. Has the Company requested an inflation adjustment in the past?

A. Yes. The Company proposed an inflation adjustment in the last two distribution rate proceeding, Docket No. DE 05-178 and DE 10-055. Staff recommended disallowing the inflation adjustment in both of those proceedings. The adjustment remains inappropriate in this proceeding.

Eliminate 2017 Wage Increase

Q. Please explain Staff's recommended adjustment: Eliminate 2017 Wage Increase.

A. The Company has proposed a wage and salary increase for 2017, which is more than twelve months past the end of the test year. The Company has included a 4.0 percent increase for UES Non-union effective January 1, 2017, Union increase of 3.0 percent effective June 1, 2017, and USE increase of 4.0 percent effective January 1, 2017.[28] In addition, the 2017 non-union compensation program has not been approved.[29] Staff's adjustment removes this increase as it is too far beyond the end of the test year and is not known and measureable. The Company is attempting to create an estimated future test year and its request should be denied. The adjustment is shown on Schedule 3.6.

Eliminate Increase to 401(k) Associated with 2017 Wage Increase

Q. Please explain Staff's recommended adjustment: Eliminate Increase to 401(k) Associated with 2017 Wage Increase.

A. The Company's 2017 proposal to increase 2017 wages results in an increase in its 401(k) program. Consistent with Staff's adjustment to eliminate the 2017 wage increase, the increase to the 401(k) should also be removed. The adjustment is supported by Staff witness James J. Cunningham. The adjustment is shown on Schedule 3.7.

Eliminate 2017 Increase in Medical and Dental Insurance

Q. Please explain Staff's recommended adjustment: Eliminate 2017 Increase in Medical and Dental Insurance.

---

[28] UES Schedule RevReq-3-1, footnote (4), updated September 16, 2016

[29] UES response to Staff 5-33 (Attachment DHM-8).

A. Staff's adjustment removes the Company's 2017 increase in medical and dental insurance expenses as supported by Staff witness James J. Cunningham. The adjustment is shown on Schedule 3.8.

Eliminate Restricted Stock Plan and EPS Component of Incentive Compensation

Q. Please explain Staff's recommended adjustment: Eliminated Restricted Stock Plan and EPS Component of Incentive Compensation.

A. The Company has a Restricted Stock Plan that is awarded based exclusively on accomplishing shareholder focused goals. The Company's Incentive Compensation Plan also has a significant focus on shareholder related goals. Staff's adjustment removes the Restricted Stock Plan and the portion of Incentive Compensation that is related to shareholder goals. The adjustment is shown on Schedule 3.9.

Q. Please explain the part of Staff's adjustment regarding Restricted Stock.

A. The Company's Restricted Stock Plan grants Share and Restricted Stock Units with the objectives of the plan "to optimize the profitability and growth of the Company through incentives that are consistent with the Company's goals and which <u>link the personal interests of Participants to those of the Company's shareholders</u>… [emphasis added]."[30] The Plan document states that the performance measures to be used for awards "shall be chosen from among earnings per share, economic value added, market share (actual or targeted growth), net income (before or after taxes), operating income, return on assets (actual or targeted growth), return on capital (actual or targeted growth), return on investment (actual or targeted growth), revenue (actual or targeted growth), share price, stock price growth, total

[30] UES response to Staff 5-38, Attachment 3, page 2 of 15 (Attachment DHM-9).

shareholder return, or other performance measures as are duly approved by the Committee and the Company's shareholders."[31] All of these goals are focused on benefit for the Company's shareholders. Since award is based on accomplishing goals associated with the interest of the Company's shareholder, Staff's adjustment transfers the responsibility for funding the plan to the shareholders where it belongs.

Q. How much has the Company expensed related to the Restricted Stock Plan in the test year?

A. During the test year, $1.83 million was expensed related to the Restricted Stock Plan. Through the USC billing process, $370,760 was allocated to UES as O&M expenses in the test year and $148,366 was allocated to UES capital charges.[32] The Company stated that these costs were not adjusted for annual payroll increases. Staff's adjustment appropriately removes the amount allocated to UES for both expenses and rate base for the test year.

Q. Is Staff's recommended adjustment to Incentive Compensation also based on transferring the responsibility of funding to the shareholders that receive the benefit of the goals achieved?

A. Yes. Staff has applied the same logic to the Incentive Compensation program. However, only a portion of the Incentive Compensation should be transferred to the shareholders, since some of the goals are focused on ratepayers.

Q. Please elaborate.

---

[31] UES response to Staff 5-38, Attachment 3 (Attachment DHM-9).
[32] UES response to Staff 8-20, Attachment 1 (Attachment DHM-10).

A. The Company has a management Incentive Compensation Plan. (Union employees are not eligible for incentive compensation.) The amended and restated Plan document states that the participation is for "employees of Unitil Corporation and its subsidiaries" (of which UES is a participant).[33] Prior to the beginning of each Performance Period, objectives are established that must be achieved prior to award. The objectives are given a ranking "based on the relative impact of each Performance Objective on the Corporation's performance."[34] The goals are the same for both senior management and non-union employees. Union employees are not eligible for participation.[35] The following table provides the Performance Objective and relative weight for 2012 through 2015. Also included is the amount of Incentive Compensation that was charged to UES.

Table 4: Incentive Compensation Performance Measures, Weighting, and Amount Charged to UES for 2012-2015

	Weight of Measure			
Measure	**2012**	**2013**	**2014**	**2015**
Earnings per Share (EPS)	25%	40%	40%	40%
3 Year Average Return on Equity vs. Peers	15%			
Gas Safety-Response to Ordor Calls	10%	10%	10%	10%
Reliability-SAIDI Minutes	10%	10%	10%	10%
Customer Satisfaction	10%	10%	10%	10%
Residential Distribution Rates*	30%			
O&M Cost per Customer*		30%	30%	30%
	100%	100%	100%	100%
Total Incentive Compensation	1,929,586	2,391,243	3,754,132	3,737,123
Allocation Factor-UES	31.73%	31.76%	30.44%	28.32%
Total Incentive Compensation to UES	612,257	759,459	1,142,758	1,058,353
Check				*1,058,353*

*Measured against Peers

Q. How much of the Incentive Compensation costs does Staff believe should be funded by shareholders?

[33] UES response to Staff 5-38, Attachment 2 page 1 of 5 (Attachment DHM-9).
[34] UES response to Staff 5-38, Attachment 1, page 2 of 5 (Attachment DHM-9).
[35] UES response to Staff 5-38. (Attachment DHM-9).

A. Forty percent. For the last three years (2013-2015), Earnings per Share has been weighted 40%. EPS is a shareholder-related goal. Therefore, the Company's shareholders should fund that portion of the Incentive Compensation that is focused on their behalf. The result is a sharing between the shareholders and ratepayers who each receive some benefit from the accomplishment of the goals.

Q. Please explain why Staff believes that the shareholders should fund the Restricted Stock Plan and the EPS portion of Incentive Compensation and not the ratepayers.

A. The award of Restricted Stock is based on goals like earning per share (EPS), which are driven by increases to net income or profitability. Forty percent of the weighted goals for Incentive Compensation payout are awarded based on achieving a specified EPS goal. EPS or profitability goals are aligned with the interests of the Company's shareholders. There is a significant monetary incentive for management to focus on these shareholder-focused goals in order to obtain payouts through the Restricted Stock Plan and Incentive Compensation. To increase profitability during a period of slow revenue growth, a company must focus on reducing expenses (or increase its authorized return on its assets). While reducing expenses can and should benefit ratepayers, taken to an extreme, it can harm customers.

Q. Please explain why focusing on shareholder-related goals can hurt ratepayers.

A. Reducing expenses drives up net income or profitability that should benefit ratepayers. However, if there is an over focus on profitability in order to receive Restricted Stock or Incentive Compensation payouts, the shareholders are receiving benefit at the expense of ratepayers. For example, expenses can be reduced by deferring maintenance (resulting in increased outages). Further, expenses can be reduced by failing to adequately staff Customer Services. As an example, customers could have an outage and be without power and it is difficult to access customer service to report the outage. Customer services will also have long weight times for other inquiries, or complaints if it is understaffed to reduce costs and drive up profitability. By reducing expenses, the Company's management has met its EPS goal (40%) and O&M Cost per Customer goal (30%). Increased outages from deferred maintenance and lack of customer access to report the outages will result in the Company failing to achieve its Reliability goal (10%) or customer satisfaction goal (10%), but management has achieved 70% of its weighted goals at the expense of the customer.

Having goals to incent performance is a good management practices, however, it is important that incentive payments are based on performance goals that derive the desired behaviors. The Company has made the decision to put shareholders' goals above those of the ratepayers. Therefore, shareholders should fund the awards that accrue to management for achieving the goals that benefit them. Ensuring that the competing interests are balanced is also important. This balance has been achieved by requiring the sharing of incentive compensation between ratepayers and shareholders. Therefore, Staff is recommending the portion of the Incentive Compensation that more closely benefits shareholders be funded by shareholders.

Q. Is there a related adjustment to rate base?

A. Yes, an adjustment was made to remove the Restricted Stock Plan and EPS Component of Incentive Compensation that the Company allocated to capital.

Eliminate 2017 Increase in Insurance Premiums

Q. Please explain Staff's recommended adjustment: Eliminate 2017 Increase in Insurance Premiums.

A. The Company included estimates for 2017 increases to various property and liability policy premiums. These costs represent costs that are not known and measureable and will occur beyond one year past the end of the test year. Staff's adjustment replaces these 2017 unknown and unmeasured estimates with the 2016 premium costs provided by the Company to limit the increase to within one year past the end of the test period. The adjustment is shown on Schedule 3.10.

Property Taxes

Q. Please explain Staff's recommended adjustment: Modification to Property Taxes?

A. The Company included a workpaper showing the municipal and state property taxes for each jurisdiction. The workpaper included the tax rate and assessed value of the property for the test period resulting in a total for property taxes of $5,397,120. After removing the Test Year Property Tax Abatements, the Total Test Year Property Tax Expense is $5,029,628. The Company's proforma adjustment to property taxes is an increase of $1,030,081. Staff's adjustment makes several modifications to the Company's proforma property tax increase. The adjustment is shown on Schedule 3.11.

Q. Please explain what is included within the Company's proforma adjustment to Property Taxes and what Staff is recommending for adjustment.

A. The Company included property taxes for the post-test year addition of the Kingston Substation totaling $232,678. Staff is not disputing the addition of the Kingston Substation nor the additional property taxes that will be incurred. However, Staff is concerned about the method used to estimate property taxes for the other property in service. The Company proforma adjustment used an "average annual compound growth rate" from 2011 to 2015 calculated to be 7.97%. Using a five-year average of the changes in property taxes is not known and measureable. Even if the Commission is willing to accept an estimate, it is questionable whether the method used by the Company to calculate the average grow rate would even be a good estimate. The Company's method results in an estimated increase in property taxes of $429,911. An average of the last five years increase in property taxes is only $356,253.

In addition, the Company calculation of the "average annual compound growth rate" did not recognize the 2015 property tax abatement of $367,492, thus overstating the amount of 2015 property taxes that was used to calculate the growth rate.

Q. What is Staff's recommended adjustment?

A. Staff recommends that the Company's biased increase to property taxes using the Company's calculated "average annual compound growth rate" be denied. The increase of $232,678 for the addition of the Kingston Substation acknowledges the known and measureable increase for 2016.

Sharing of Directors and Officers Liability Insurance

Q. Please explain Staff's recommended adjustment: Sharing of Directors and Officers (D&O) Liability Insurance.

A. Staff's adjustment removes one-half of the D&O Liability Insurance expense. The removal of one-half of this expense reflects a sharing of this insurance between shareholders and ratepayers. The adjustment is shown on Schedule 3.12.

Q. Why should the cost of D&O Liability Insurance Expense be shared between shareholders and ratepayers?

A. D&O Liability Insurance protects the officers and directors from the costs of a lawsuit. Shareholders benefit from payouts under the policy that would reduce the cost not recoverable from ratepayers. On the other hand, ratepayers benefit because having the insurance improves the ability of the Company to attract and retain qualified directors and officers and enables the directors and officers to make decisions without fear of personal liability. As a result, it is reasonable for shareholders to bear some of the cost of D&O Liability Insurance.

Q. Is there a related adjustment to rate base?

A. Yes, an adjustment was made to remove one half of the D&O Liability Insurance that the Company allocated to capital.

Modifications to Depreciation and Amortization Expense

Q. Please explain Staff's recommended adjustment: Modifications to Depreciation and Amortization.

A. Staff's Modification to Depreciation and Amortization adjustment is supported by Staff witness James J. Cunningham. The results of that adjustment are shown on Schedule 3.8.

True-Up Payroll Taxes for Other Adjustments

Q. Please explain Staff's recommended adjustment: True-Up Payroll Taxes for Other Adjustments.

A. Payroll taxes reflects the effective tax rate for the Company's Social Security and Medicare taxes that correspondingly decrease as a result of Staff's adjustments to employee compensation. The adjustment is shown on Schedule 3.14.

Interest Synchronization

Q. Please explain Staff's recommended adjustment: Interest Synchronization.

A. The interest synchronization adjustment synchronizes the rate base and cost of capital with the tax calculation using Staff's recommended weighted cost of debt. The adjustment is shown on Schedule 3.15.

Q. What is the impact of Staff's recommended adjustments to the Company's updated operating income?

A. The Company updated operating income was $9,470,010. Staff's recommended adjustments increases operating income to $10,500,730.

Conclusions

Q. In conclusion, what is Staff's recommended increase to base revenue?

A. Staff is recommending that the Company be allowed an increase to its distribution base rates of no more than $2,485,637 in base rates.

Q. Does this conclude your testimony?

A. Yes.