STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DOCKET NO. DE 16-384

IN THE MATTER OF: UNITIL ENERGY SYSTEMS, INC.

REQUEST FOR CHANGE IN RATES

DIRECT TESTIMONY

OF

James J. Cunningham, Jr.
Utility Analyst

NOVEMBER 16, 2016

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

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

Q. Please summarize your educational and professional background.

A. Please refer to Appendix A.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide my recommendations on (1) depreciation and amortization expense, with associated impacts on the depreciation accrual rates used in the proposed 2016 Rate Plan, (2) employee pensions and benefits expense, including pensions, post-employment benefits other than pensions (PBOPs), supplementary executive retirement plans (SERP), 401-k expenses, and medical and dental expenses and (3) accounting for contributions in aid of construction (CIAC) associated with the new LED lighting tariff.

Q. Please summarize your recommendations.

A. Table 1 provides a comparison of the Company's proposed amounts and my corresponding recommendations.

Table I

Summary of Proposed and Recommended Amounts

	Proposed	Recommend	Increase/ (Decrease)
Depreciation	$ 9,943,800	$ 9,936,299	$ (7,501)
Amortiz. of Software	$ 541,123	$ 505,274	$ (35,849)
Pensions	$ 1,112,378	$ 1,112,378	$ 0
PBOP's	$ 1,038,139	$ 1,038,139	$ 0
SERP	$ 174,402	$ 174,402	$ 0
401k	$ 375,227	$ 361,296	$ (13,931)
Med. & Dental Exp.	$ 705,413	$ 594,614	$ (110,799)
Total Expense Items	$13,890,482	$13,722,402	$(168,080)

Schedules supporting my recommended amounts are attached as follows:

Schedule JJC-1, Summary of Recommendations
Schedule JJC-2, Depreciation
Schedule JJC-3, Amortization of Software
Schedule JJC-4, Employee Pensions and Benefits

Q. Are your recommendations reflected in the testimony and schedules of Ms. Mullinax?

A. Yes.

Depreciation and Amortization

Q. What plant accounts are included for purposes of calculating depreciation expense?

A. Only depreciable plant accounts are used in the calculation of depreciation expense. Non-depreciable plant, such as land and rights of way, are excluded since such accounts have an indeterminate life. Amortization expense pertains to intangible software.

Q. What technique do you use to calculate your depreciation recommendation?

A. My testimony utilizes the whole-life (WL) technique for calculating depreciation rates. The whole-life technique is consistent with the Commission's practice for setting depreciation accrual rates for other electric companies and for natural gas and water utilities. This technique is also the basis for the Commission-approved depreciation accrual rates that are currently in place for UES.

The WL technique allocates the original cost less the estimated net salvage[1] over the total estimated life of the investment. The WL formula is defined as follows:

$$\text{WL Depreciation Accrual Rate} = \frac{\text{1-Net Salvage Rate (NSR)}}{\text{Average Service Life (ASL)}}$$

For instance, assuming an average service life of 10 years and a net salvage rate of 20 percent, the whole-life depreciation accrual rate is calculated to be 0.08, as follows: 1 - 0.20 / 10 = .08 (or 8.0%).

To the extent that the updated average service lives or net salvage rates turn out to be different than previously estimated, the whole-life technique provides for an amortization of this difference over a short period of time, generally between five to ten years.

Whole-life depreciation accrual rates are easy to administer since the formula is straightforward and the rates remain unchanged until the Commission approves new depreciation accrual rates in subsequent base rate cases.

Q. Are the depreciation accrual rates proposed by UES based on the whole-life technique?

A. Yes. The depreciation accrual rates used by UES are based on the rates approved by the Commission in Docket No. DE 10-055.[2]

Q. Please explain the reduction in depreciation expense that you recommend.

A. The reduction reflects two adjustments to plant balances identified in the NHPUC Audit Report[3] and other minor adjustments. The two items identified in the Audit Report pertain to plant retirements that should have been removed from plant

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[1] Net salvage represents the estimated gross salvage less the estimated cost of removal at retirement.
[2] Reference: Docket DE 10-055, Settlement Agreement, Attachment 6.
[3] Reference: Audit Report, August 8/5/2016, Audit Issue No. 2 (p. 81) and No. 3 (p. 82) (attached).

balances at December 31, 2015. I'm removing these amounts from the plant balance for purposes of calculating depreciation expense. The other minor adjustments pertain to rounding differences in depreciation accrual rates. Based on these adjustments, I recommend depreciation expense of $9,936,299, a reduction of $7,501 from the proposed depreciation expense of $9,943,800. A summary of my recommendation is provided in Schedule JJC-2 (attached).

Q. Please continue by explaining your recommendation for amortization of software.

A. Amortization relates to the periodic allocation of costs and is generally determined on a straight-line basis, with no provision for net salvage. The amount of amortization charged to each period is determined by dividing the cost by the number of periods of expected use.

My recommendation reduces amortization for three items: software that was fully amortized in the prior 2015 test year ($236); software that has only partial amortization remaining in the 2016 rate year ($24,330); and, software that pertained to Fitchburg Electric that was inadvertently allocated to UES ($11,282). The total reduction is $35,849. A summary of my recommendation is provided in Schedule JJC-3 (attached).

<u>Pension Expenses</u>

Q. Please summarize the rationale used to develop your recommendation for pension expense.

A. My recommendation is based on the Actuarial Report prepared by Transamerica.[4] This Report was prepared in accordance with accounting requirements under Financial Accounting Standards Board. The major expense components in the Report are as follows:

- *Service costs:* actuarially determined present value of benefits attributed to services provided by employees during the current period.
- *Interest costs:* increase in projected benefit obligation due to the passage of time.
- *Expected Return on Plan Assets:* estimated return earned by the accumulated fund assets during the year.
- *Amortization of costs that are not yet recognized as expense:* prior service cost attributable to plan amendments including provisions to increase or decrease benefits for employee service provided in prior years;
- *Amortization of Net (Gain)/Loss:* gains or losses attributable to changes in the market value of plan assets and changes in actuarial assumptions that affect the amount of projected benefit obligation;

Pension expenses are driven primarily by estimated discount rates and estimated returns on plan assets. The discount rate used by Transamerica is 4.3 percent and the estimated return on plan assets is 8 percent, both of which are reasonable estimates in my view.[5]

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[4] Reference Staff 2-33, Attachment 1, page 4 of 4 for the actuarial summary of pension expense and Staff 2-33, Attachment 3, page 2 of 25 for the complete Actuarial Report. The complete Actuarial Report includes all affiliates, including UES and USC which are reflected in revenue requirements in this filing.

[5] Reference Staff Technical Session 1-6 for more information on discount rates and return on plan assets provided by UES (attached).

In addition to the above, UES allocates a portion of pension expense to capital projects, with the remaining amount charged to operations. This charge to operations is the amount that is included in revenue requirements in this case.

Q. Have there been any changes made to UES' pension expenses recently?

A. YES. UES is part of the overall Corporate Retirement Plan; and, there were changes made to the overall Corporation Retirement Plan which, in turn, affected its UES affiliate. Mr. Long indicates in his testimony that, effective January 1, 2010, Unitil Corporation closed the defined benefit Retirement Plan to new non-union hires; and, effective June 1, 2012, closed the defined benefit Retirement Plan to new union employees. Newly hired union and non-union employees are not eligible for any benefits from the defined benefit pension plan, but rather will receive all of their retirement benefits from an enhanced 401-k plan.

Q. Are these changes incorporated in the Transamerica Actuarial Report and in UES pension expense amounts proposed for 2016 in this filing?

A. Yes these changes are reflected in the Transamerica Actuarial Report and in the amounts UES is proposing for pension expense for 2016 in this filing.

Q. What is your recommendation for pension expense for UES for 2016?

A. My recommendation for pension expense is $1,112,378, the same amount recommended in the Transamerica Report, net of capital charges, and the same amount that UES included in its filing for 2016.

<u>Post Employment Benefits Other Than Pensions (PBOPs)</u>

Q. Please summarize the rationale used to develop your recommendation for PBOPs expense.

A. My recommendation is based on the Actuarial Report prepared by Transamerica.[6] This Report was prepared in accordance with accounting requirements under Financial Accounting Standards Board.

Q. Please identify the expense components of PBOPs expenses and provide a definition of each component.

A. The expense components and related definitions are the same as provided above for pension expense.

Q. What is your recommendation for PBOP expenses?

A. My recommendation for PBOP expenses is $1,038,139, the same amount recommended in the Transamerica Report, net of capital charges, and the same amount that UES included in its filing for 2016.

Q. How did you develop your recommended amount for PBOP's expenses?

A. My recommendation is based on the amount calculated in Transamerica Actuarial Report. UES is proposing the same amounts for 2016 in this filing. As noted above for pension expenses, PBOPs expenses are driven primarily by estimated discount rates and estimated returns on plan assets. The discount rate used by the actuary is 4.3 percent and the estimated return on plan assets is 8 percent, both of which are reasonable estimates in my view.

Q. Have there been any changes in PBOP plan recently?

[6] Reference Staff 2-35, Attachment 1, p. 4 of 4 for the actuarial summary for PBOPs and Staff 2-35, Attachment 3, p. 13 of 22 for the complete actuarial report. The complete Actuarial Report includes all affiliates, including UES and USC which are reflected in revenue requirments in this filing.

A. Yes. Mr. Long indicates in response to discovery that the Company and the International Brotherhood of Electrical Workers ("IBEW") negotiated a change in health insurance coverage. The change was requested by the IBEW because their existing insurer, the New England Electrical workers' benefit fund ("NEEWBF") was in poor financial condition and was projecting a 30 percent mid-year 2015 premium increase with another large increase projected for early 2016. The Company and the IBEW agreed to move insurance coverage for UES Union active employees and retirees from the NEEWBF to Health Plans, Inc. the insurance provider for all other Unitil employees and retirees.

Q. Are these changes incorporated in the Transamerica Actuarial Report and in UES PBOP expense amounts proposed for 2016 in this filing?

A. Yes these changes are reflected in the Transamerica Actuarial Report and in the amounts UES is proposing for PBOP expense for 2016 in this filing.

Q. What is your recommendation for PBOPs expense for UES for 2016?

A. My recommendation for pension expense is $1,112,378, the same amount recommended in the Transamerica Report and the same amount that UES included in its filing for 2016.

<u>Supplementary Executive Retirement Plan (SERP)</u>

Q. How did you develop your recommendation for supplementary executive retirement plan (SERP) expense?

A. My recommendation is based on the final Actuarial Report prepared by Transamerica for 2015 SERP.[7] This Report was prepared in accordance with accounting requirements under Financial Accounting Standards Board. UES is proposing $174,402 in expense for its defined benefit SERP in calendar year 2016, the same amount as reflected in the 2015 test year.

Q. When will the final Actuarial Report be available for calendar year 2016; and, are you planning to update your recommendation based on the information in the final report?

A. I believe that the final Actuarial Report for 2016 will be available in December 2016 or January 2017. I recommend that UES provide a copy of Transamerica's final 2016 SERP Actuarial Report and, at that time, I'll review it for any material changes, such as a change in the wage and salary assumptions, mortality rates, retirement dates and discount rates, and update my recommendation. In the meantime, I recommend SERP expense of $174,402.

Q. Can you provide some background about the Unitil Corporation SERP.

A. Yes. There is very little information in the filing about the SERP; however, UES provided information in response to discovery requests. UES provided a copy of the SERP Plan[8] which indicates that the SERP is a "defined benefit" SERP.[9] It was originally established effective January 1, 1987, and was amended and restated effective January 1, 1998, and amended and restated, effective December 31, 2007. It is designed to provide supplemental retirement income to designated

[7] Reference: Unitil SERP Actuarial Report, prepared by Transamerica (attached).
[8] Reference: Technical Session 1-11 (Attachment 1)
[9] A "defined benefit" plan is a type of retirement plan in which an employer promises a specified monthly benefit on retirement. By comparison, a "defined contribution" plan is a type of plan that provides retirement income based on contributions by an employer, employee or both, plus investment earnings.

employees which, when combined with other employment-related and government sponsored retirement benefits, will provide for a specified aggregate level of retirement benefits. The principle objective is to ensure the payment of a competitive level of retirement income in order to attract, retain and motivate selected executives.

Q. Do other companies provide SERP to its senior executives?

A. Yes. In discovery, UES provided information about SERP plans offered by other companies in its proxy peer group. Some are defined benefit SERPs and others are defined contribution SERPs.[10]

Q. Are the payments received by a SERP participant tied to performance metrics?

A. No. SERP is a retirement program and is not tied to performance metrics and does not directly reward key executives for attainment of financial results; rather it is based solely on compensation earned by the executives during their active employment years.[11]

Q. How many executives are designated as participants are in SERP?

A. In 2016, there are 6 participants – 5 active senior executive employees and 1 retired employee. SERP is now closed to <u>new</u> hires.

Q. Although SERP is now closed to new hires, is it also closed to <u>existing</u> employees?

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[10] Reference: Staff 1-13 (attached).
[11] Reference: Staff 10-9 (attached).

A. No, although SERP is closed to new hires, SERP remains open to <u>existing</u> employees who might be promoted to senior executive positions.[12]

Q. Do you expect that the number of participants in the SERP could increase in future years?

A. Yes. Although the SERP Plan is closed to new hires, existing employees are still allowed to participate in the SERP Plan provided they are designated by the Board of Directors. I believe that the total number of SERP participants could increase relatively quickly in the near term. Specifically, according to the SERP Actuarial Report, 5 active senior executives are expected to retire over the next five years;[13] and, these senior executives could be replaced by existing employees. In this scenario, the number of SERP participants could increase from 6 participants to 11 participants – i.e., 5 active senior executives and 6 retired employees.

Q. Given the scenario that the existing 5 senior executives could be replaced by "existing" employees, do you believe that SERP expenses might increase quickly and significantly?

A. Yes. The actuarially determined SERP expenses provided by Transamerica pertain to active participants and retired employees. Therefore, it appears reasonable to assume that SERP expenses could nearly double in five years, if SERP participation nearly doubles in five years. Of course, a more accurate estimate of SERP expense would be provided in an Actuarial Report which would

[12] Reference: Staff 10-8 (attached).
[13] Op.cit. SERP Actuarial Report prepared by Transamerica (page 10).

include assumptions pertaining to discount rates, wage and salary changes, mortality rates and retirement dates, survivorship options, etc.

Q. Are SERP expenses recovered from ratepayers?

A. Yes. In this filing, UES is proposing to recover $174,402. If participation doubled and SERP expense doubled, the annual amount recovered from ratepayers could double to $348,804 in future years.

Q. Given the potential doubling of SERP participation and SERP expense, what is your recommendation for the SERP?

A. I recommend that, effective January 1, 2017 the defined benefit SERP be closed to new participation and that the Commission not authorize recovery by ratepayers of SERP expense for any new senior executive participants. After January 1, 2017, UES might propose a new SERP for its senior executives; but, I recommend that any new SERP be reviewed and approved by the Commission before implementation.

Q. Explain why you believe your recommendation is reasonable?

A. My recommendation will help to stabilize the expense recovered from ratepayers, while not harming shareholders. Also, my recommendation will not diminish the stated objective of the SERP to provide supplemental retirement income to designated employees nor will it change the benefits for the existing 5 senior executives and 1 retired employee, for which the Commission has authorized recovery in the past. A similar approach was taken by the Connecticut

Commission in a case pertaining to Connecticut Light and Power (CL&P). The Connecticut Commission closed the SERP at CL&P effective January 1, 2006.[14]

Q. Subsequent to January 1, 2017, you recommend that the defined benefit SERP be closed to new participation. Will this closure diminish the ability of the Unitil Corporation to pursue the objective of providing supplemental retirement income to designated employees?

A. No. The existing "defined benefit" SERP plan will continue to provide supplemental retirement income for the existing 6 participants (5 senior executives and 1 retired employee) and their beneficiaries. For new senior executives, my recommendation does not prohibit Unitil Corporation from pursuing its objective of providing supplemental retirement income for designated employees. For instance, the Company could offer a new "defined contribution" SERP for new senior executives. In fact, some of the companies in Unitil Corporation's proxy peer group appear to offer defined contribution SERP plans.

<u>401-k Expenses and Medical Expenses</u>

Q. What is your recommendation for 401-k expense and medical expense?

A. My recommendation for 401-k expenses is $361,296, a reduction of $13,931 from the proposed amount of $375,227. Please reference Schedule JJC-4 for more details.

[14] Reference Connecticut Commission decision in Docket No. 14-05-06, starting at page 62: http://www.ct.gov/pura/lib/pura/pressreleases/2014/140506-121714puraruling.pdf.

My recommendation for medical expenses is $594,614, a reduction of $110,799 from the proposed amount of $705,413. Please reference Schedule JJC-4 for more details.

Q. Please explain your recommendation to reduce 401k and medical and dental expense?

A. I modified UES's proposal to exclude 2017 pro forma adjustments of $13,931 for 401-k expenses and $110,799 for medical expenses. These pro forma adjustments are more than twelve months subsequent to the end of the 2015 test year. I recommend these amounts be excluded, consistent with Commission practice which considers pro forma adjustments only for the twelve months immediately following the end of the 2015 test year.

Q. Please continue with your explanation of why you do not support the 2017 pro forma adjustment proposed by UES.

A. The Commission's long standing practice has been to use an historic average test year approach for determining revenue requirements. This approach utilizes readily available information. For instance, operating results are modified by adjustments such as depreciation expense adjustments to reflect year-end plant balances. However, it's not the Commission's practice to make extensive adjustments to operating results beyond twelve months after the end of the test year. Such extensive adjustments would diminish the simplicity of the average test year approach.

Q. In the past, has UES proposed pro forma adjustments that are beyond the twelve month period after the end of the test year?

A. No, not to my knowledge. The last rate case filed by UES was in docket DE 10-055. In that case, UES did not propose an adjustment that went beyond the twelve months subsequent to the end of the test year.

Q. With respect to UES's NH Gas Division (Northern), has UES proposed any pro forma adjustments that are beyond the twelve month period after the end of the test year?

A. No. In the last two rate cases filed by UES for Northern Utilities, the company's proposed pro forma adjustments were limited to those pertaining to that pertained to known and measurable adjustments were within the first full year after the test year.[15]

<u>2016 Rate Plan</u>

Q. Do you have any comments about the proposed 2016 Rate Plan?

A. Yes. I believe the 2016 Rate Plan should provide for individual depreciation accrual rates rather than a composite depreciation accrual rate as referenced in the original filing, DLC-2. The individual depreciation accrual rates provide a more accurate calculation of depreciation expense. Therefore, I recommend that UES incorporate individual depreciation accrual rates as currently authorized by the Commission.[16] Also, I believe the 2016 Rate Plan, DLC-3, should provide a line item for plant retirements. As noted earlier in my testimony, the NHPUC Audit Report identified an issue pertaining to retirements and UES indicated in its

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[15] Reference: Testimony of David L. Chong, Docket DG 11-069, page 12 of 43; and, DG 13-086, page 6 of 34.

[16] Reference: Docket DE 10-055, Settlement agreement, Attachment 6, and, Schedule JJC-1.

response that it would review its processes and modify where appropriate to ensure that retirements were made. Therefore, I recommend that UES incorporate a line item in its 2016 Rate Plan that reflects retirements.

<u>New LED Tariffs</u>

Q. Please explain the new unit rates used to develop the LED Tariffs.

A. The embedded cost of service study, prepared by Mr. H Edwin Overcast, Ph.D, explains the company's proposal. The Company proposes that any customer wishing to convert to LED will pay the cost of the new LED equipment, the actual cost of installation and the undepreciated book value of the current lighting equipment being removed. In addition, the company proposes to charge separately for any maintenance costs relating to the new led fixture on a per-visit basis.[17] This embedded cost methodology appears reasonable for purposes of developing customer charges in the new LED Tariff.

Q. Do other NH Electric Utilities treat the installed cost of new LED lighting equipment and the undepreciated book value of the current lighting equipment in a uniform manner?

A. There appear to be differences among the Electric Utilities (UES, Liberty and Eversource) in the treatment of the installed cost of new LED lighting equipment and the undepreciated book value of the current lighting equipment.[18] The

[17] Reference: Testimony of Mr. Overcast, PHD, Exhibit HEO-1, page 66 of 84 (Bates 702).
[18] Ibid.

Commission may want to develop uniform standards with respect to LED lighting.

Q. How will UES account for customer payments?

A. Cash payments received from customers will be treated as contributions in aid of construction (CIAC). In discovery, UES advised that upon receipt of a customer CIAC, the cash will be applied to the project in CWIP. Once the project is complete the CIAC related to the cost of removal (COR) will offset the actual COR and the amount of any remaining unexpired life will be transferred to accumulate depreciation. The portion of the CIAC related to the LED fixtures will reduce the cost of the asset placed in service.[19]

Summary of Testimony

Q. Please summarize your testimony.

A. As noted in Table 1, at the outset of my testimony, I recommend the following amounts:

Summary of Proposed and Recommended Amounts

	Proposed	Recommend	Increase/ (Decrease)
Depreciation	$ 9,943,800	$ 9,936,299	$ (7,501)
Amortiz. of Software	$ 541,123	$ 505,274	$ (35,849)
Pensions	$ 1,112,378	$ 1,112,378	$ 0
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SERP	$ 174,402	$ 174,402	$ 0
401k	$ 375,227	$ 361,296	$ (13,931)
Med. & Dental Exp.	$ 705,413	$ 594,614	$ (110,799)
Total Expense Items	$13,890,482	$13,722,402	$(168,080)

[19] Reference Staff 7-5 and Technical session 1-5 (attached).

Q. In addition to the numerical values noted above, please summarize other recommendations you have made throughout your testimony.

A. With respect to Employee Pensions and Benefits (Account 926):

SERP: I recommend that, effective January 1, 2017 the defined benefit SERP be closed to new participation and that the Commission not authorize recovery by ratepayers of defined benefit SERP plans for new senior executive participants. After January 1, 2017, if UES proposes any new SERP plans, such as defined contribution plans, I recommend that such SERP plans be reviewed and approved by the Commission before implementation.

In addition, I recommend a preliminary estimate of $175,402, same amount as proposed, for SERP expense for year 2016. This amount is based on the 2015 Final Actuarial Report; and, I recommend that UES provide a copy of the 2016 Final Actuarial Report from Transamerica so that I can review any material changes during the pendency of this proceeding.

2017 Inflation Adjustment – 401(-k) and Medical and Dental Expenses:

The filing incorporates a pro forma adjustment for 2017 inflation for 401-k and medical and dental expenses. The adjustment is more than twelve months subsequent to the end of the 2015 test year. Therefore, consistent with Commission practice, I recommend these amounts be excluded.

2016 Rate Plan: I believe the 2016 Rate Plan should provide for individual depreciation accrual rates rather than a composite depreciation accrual rate as referenced in the original filing, DLC-2. The individual depreciation accrual rates provide a more accurate calculation of depreciation expense. Therefore, I recommend that UES incorporate individual depreciation accrual rates as currently authorized by the Commission.[20]

Also, I believe the 2016 Rate Plan, DLC-3, should provide a line item for plant retirements. As noted earlier in my testimony, the NHPUC Audit Report identified an issue pertaining to retirements and UES indicated in its response that it would review its processes and modify where appropriate to ensure that retirements were made. Therefore, I recommend that UES incorporate a line item in its 2016 Rate Plan that reflects retirements.

New LED Tariff: I believe that the embedded cost based methodology that is used to develop customer charges for the new LED Tariff is reasonable and I recommend that the Commission approve it.

Q. Does that complete your testimony?

A. Yes, it does, thank you.

[20] Reference: Docket DE 10-055, Settlement agreement, Attachment 6, and, Schedule JJC-1.