STATE OF NEWHAMPSHIRE

PUBLIC UTILITIES COMMISSION

DG 10-017

<u>In the Matter of:</u>
<u>EnergyNorth Natural Gas, Inc. d/b/a/ National Grid NH</u>

Direct Testimony

of

James J. Cunningham

October 22, 2010

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 S. Fruit Street, Suite 10, Concord New Hampshire, 03301.

Q. Please summarize your educational and professional background.

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

Q. What is the purpose of your testimony?

A. My testimony provides recommendations on: (1) pension expenses; (2) other post employment benefits (OPEBs); (3) health and hospitalization costs; (4) depreciation and amortization; and (5) the proposed reconciling mechanism for pensions and OPEBs.

Q. Please summarize your recommendations.

A. EnergyNorth Natural Gas, Inc. (EnergyNorth or Company) is proposing $1,995,447 for pension expenses. My recommendation is $2,422,359, an increase of $426,912 from the proposed amount.

With respect to OPEBs, EnergyNorth is proposing $1,019,805. My recommendation is $548,521, a reduction of $471,284 from the proposed amount.

For health and hospitalization costs, EnergyNorth is proposing $1,708,913. My recommendation is $1,686,945, a reduction of $21,968 from the proposed amount.

With respect to depreciation and amortization, the Company is proposing $8,042,552. My recommendation is $7,888,455, a reduction of $154,097 from the proposed amount.

Overall, for all categories, EnergyNorth is proposing $12,766,717. My recommendation is $12,546,280, a reduction of $220,437. Please refer to Schedule JJC-1 for a summary of my recommendations.

With respect to the proposed reconciling mechanism for pensions and OPEBs, I recommend that the Commission not approve the mechanism, Instead, I recommend that Commission continue with the current methodology of incorporating known and measurable adjustments to the test year amounts.

<u>Pension Expenses</u>

Q. What is your recommendation for pension expense?

A. I recommend $2,422,359 for pension expense, an increase of $426,912 from the proposed amount of $1,995,447. Please refer to attached schedule JJC-2 for a summary of these amounts.

Q. Please provide an overview of pension expenses for EnergyNorth.

A. EnergyNorth is a division of KeySpan. EnergyNorth's direct pension expenses are supported by a detailed actuarial report prepared by Hewitt Associates, LLC. In addition to direct pension expenses, pension expenses include a fair value amortization amount[1], an allocation from the NGRID and KeySpan Service Companies' costs. These amounts are offset by capital bill-outs. Schedule JJC-2 provides a summary of these pension expenses.

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

A. The major expense components of EnergyNorth's pension expenses are as follows:

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

[1] This fair value amortization pertains to the previously agreed upon purchase accounting attributable to the acquisition of EnergyNorth. The agreed upon amount is amortized over 10 years and the calculation details were provided as part of discovery (reference Staff 3-12).

- Fair Value Amortization: previously agreed upon costs related to the purchase accounting adjustment for pensions and OPEBs determined at the time of acquisition of EnergyNorth by National Grid.
- Allocated Service Company Costs: costs attributable to Corporate Services, Engineering Services and Utility Services that are allocated to EnergyNorth.
- Bill-Out Component: EnergyNorth costs that are billed out to Capital/Other projects.

Q. How did you determine your recommended amounts?

A. I calculated my recommended amounts for actuarially determined, or so-called direct expenses, based on the most recent actuarial reports prepared for KeySpan by Hewitt Associates, LLC, dated September 17, 2010. The actuarial report provides a separate amount for EnergyNorth's direct pension expenses for fiscal year 2010 and fiscal year 2011.[2] Fiscal year 2010 covers the period April 2009 to March 2010. Fiscal year 2011 covers the period April 2010 to March 2011. In order to match the two fiscal years with the rate year, I split the two fiscal year actuarial reports. Specifically, I split out 75 percent of the pension expenses from the fiscal year 2010 actuarial report to estimate pension expense for the months of July 2009 through March 2010; and, I split out 25 percent of the pension expenses

[2] EnergyNorth adjusted the fiscal year 2011 amount of direct expenses estimated by Hewitt Associates, LLC in its discovery responses. At the time of preparation of this testimony, that adjustment is still under review. My testimony incorporates the amount as adjusted by EnergyNorth , *i.e.*, $1,440,518.

from the 2011 actual report to estimate pension expense for the months of April through June.

With respect to fair value amortization, I used the amount provided by the Company that represents the previously agreed upon amortization of the pension and OPEBs related purchase accounting adjustment that was determined at the time of the acquisition of EnergyNorth by National Grid.

With respect to the allocation of costs from the NGRID and KeySpan Service Companies to EnergyNorth, I estimated these costs based on the percent relationship between allocated costs and direct costs actually recorded over the 3-year period, 2007 to 2009. I multiplied this percentage by the most recent actuarially determined direct expenses for fiscal year 2010 (April 2009-March 2010) and fiscal year 2011 (April 2010-March 2011) to estimate the amount of pension costs allocated from the NGRID and KeySpan Service Companies to EnergyNorth. I then converted these fiscal year amounts to rate year amounts (July 2009-June 2010).

With respect to capital bill-outs, I estimated these costs using the same methodology that I used to estimate allocated costs.

Please refer to the attached schedule JJC-2 for a summary of my calculations.

Q. Please explain how EnergyNorth developed proposed pension costs.

A. EnergyNorth's proposed pension expenses for the 2010 rate year (July 1, 2009 to June 30, 2010) are developed by using the same amounts reflected in the 2009 test year. The Company is seeking a reconciling mechanism for any increases or decreases to the test year and is not proposing any changes to the test year at this time. I address my recommendation on the proposed reconciling mechanism later in my testimony.

Q. Do you have any other comments about Pensions?

A. At the time this testimony was prepared, I noticed a conflict with certain information provided in discovery. Once these conflicts are resolved, I might be revising my recommendations. Specifically, I noticed a conflict with the Company's response pertaining to direct expenses. With respect to direct expenses, the amounts provided by EnergyNorth in a recent discovery response (ref. Technical Session Staff 3-10) do not match with the amounts provided by Hewitt Associates LLC (ref. Technical Session Staff 3-9). My testimony utilizes the amounts provided by EnergyNorth in its final discovery response.

Other Post Employment Benefits (OPEB)

Q. What is your recommendation for OPEBs?

A. I recommend $548,521 for OPEB expense, a reduction of $471,284 from the amount proposed of $1,019,805.

Q. Please continue by explaining how you calculated your recommended amounts for OPEB expense.

A. I used the same methodology that I used for pension expenses as described above.[3] Please refer to the attached schedule JJC-3 for a summary of my calculations.

Q. Does the amount proposed for OPEB include the impact of the Affordable Health Care Act?

A. Yes. OPEB expenses include the main provisions of the required plan design changes under the Affordable Health Care Act signed into law in March 2010, *i.e.*, restrictions on lifetime limits, extension of coverage to non-dependent children to age 26 and restrictions on annual limits. The increase for all KeySpan retiree welfare plans is estimated to be $1.76 million.[4]

Q. Do you have any other comments about OPEBs?

A. At the time this testimony was prepared, I noticed a conflict with certain responses provided in discovery; specifically, the Company's responses pertaining to direct expenses, fair value amortization and FAS-112 expenses. Once these conflicts are resolved, I might be revising my recommendations. With respect to direct expenses, the amounts provided by EnergyNorth in most recent discovery responses (ref. Technical Session Staff 3-10) do not match with the amounts provided by Hewitt Associates, LLC (ref. Technical Session Staff 3-9).

[3] EnergyNorth adjusted the fiscal year 2010 and fiscal year 2011 amount of direct expenses estimated by Hewitt Associates, LLC in its discovery responses. At the time of preparation of this testimony, these adjustments are still under review. My testimony incorporates the amount as adjusted by EnergyNorth , i.e. $260,918 for fiscal year 2010 and $161,392 for fiscal year 2011.
[4] Reference second set of discovery, Staff 2-48, 2-52 and Technical Session Staff 3-9, page 2 of 11.

My testimony utilizes the amounts provided by EnergyNorth in final discovery responses.

With respect to fair value amortization, the most recent discovery response provided by EnergyNorth (ref. Technical Session Staff 3-10) does not match with the earlier response provided by the Company (ref. Staff Set 3-13). My testimony utilizes the most recent discovery response.

Finally, with respect to FAS-112 expenses, approximately $77 thousand was added to the OPEB expense amount, but no explanation was provided or referenced. My testimony utilizes zero for this amount.

<u>Healthcare Expenses</u>

Q. What is your recommendation for healthcare expenses?

A. My recommendation for healthcare expenses is $1,686,945, a reduction of $21,968 from the proposed amount of $1,708,913.

Q. How did you develop your recommendation?

A. I used the estimated medical cost increase of 8.5 percent that was provided by Hewitt Associates, LLC. I increased the test year amount by 8.5 percent to estimate the rate year. Please refer to attached schedule JJC-4 for a summary of the calculation of the rate year amount.

<u>Depreciation Expense</u>

Q. What is your recommendation for depreciation expense?

A. My recommendation for depreciation expense is $7,888,455, a reduction of $154,097 from the proposed amount of $8,042,552.

Q. How did you develop your recommendation?

A. I used the current Commission-approved depreciation accrual rates and multiplied these rates by the December 31, 2008 plant balance for the calendar year ended December 31, 2008.[5] EnergyNorth depreciation accrual rates are slightly different from the current Commission-approved rates. I modified the proposed depreciation accrual rates to reflect the Commission-approved rates and recalculated depreciation expense. The impact of this change is a reduction of approximately $3 thousand.[6] In addition, I removed approximately $400 thousand from the plant balance for certain general plant accounts that are fully depreciated.[7] Finally, at the time of preparation of this testimony, two items are still under review. First, plant balances as of June 30, 2009 are not delineated in the filing; hence, I could not calculate depreciation as of June 30, 2009. Second, an unexplained adjustment to depreciation and/or amortization in the amount of $342,229 is proposed.[8] Although I am reflecting this reduction in my recommendation, the amount is still under review. After the Company provides additional information pertaining to the plant balances as of June 30, 2009 and the unexplained adjustment to depreciation and/or amortization, I might revise my

[5] Source of plant balances at December 31, 2008 is the filing, work paper WP COS 2-2-4 Depreciation AN 2-23-10.

[6] Slight differences are noted for two plant accounts: Plant Account 387.01-Other Distribution Plant Equipment and Plant Account 394.04-Tools, Shop and Garage Equipment (CNG).

[7] Source: Response to OCA 2-27, Attachment. The book cost of plant accounts that are fully depreciated are as follows: 393.00 Stores Equipment, $28,210; 394.04-General Tools, Equipment, CNG Station, $221,199, and; 395.00-General Laboratory Equipment $150,945.

[8] Reference Schedule JJC-5.

recommendation. Please refer to attached schedule JJC-5 for a summary of my calculations.

Reconciling Mechanism for Pensions and OPEBs

Q. The Company is requesting that the Commission authorize specific deferral accounting treatment, a reconciling mechanism, and the collection of deferred pension and OPEBs through the Company's local distribution adjustment charge ("LDAC"). Under the Company's proposal, the test year amount would be included in base rates, subject to a reconciling mechanism included in the LDAC. What is your recommendation?

A. I recommend that the Commission not approve the proposed reconciling mechanism. Rather, I recommend continuation of the current practice of addressing pension and OPEB expenses as part of an overall review of revenue and expenses in the context of the Company's periodic rate case filings. I believe the current ratemaking approach, including known and measureable adjustments to test year amounts, is appropriate and should be retained. Changes in pensions and OPEBs will continue to exist; however, such changes do not exist in isolation of all other expenses. For this reason, I believe it would not be appropriate to isolate the on-going effect of pension and OPEB expense. Rather, I recommend that the Commission continue to use the traditional ratemaking approach of examining changes in pension and OPEB expenses as part of an overall examination of revenue and expenses in the context of periodic rate case filings.

Q. Can you reference a recent Commission Order that supports traditional ratemaking for pensions and OPEB expense?

A. Yes, in EnergyNorth's previous rate case, Docket No. DG 08-009, the Commission issued Order No. 24,972 (May 29, 2009) approving the settlement agreement in that case which affirmed the traditional ratemaking approach for pension and OPEB costs. Commission Order No. 24,972 did not approve the annual adjustment for pensions and OPEB costs. The order states:

> Pension-OPEB costs are included in the revenue requirement and delivery rates will not be adjusted annually for fluctuations in those costs. Such treatment is reasonable, as pension-OPEB expenses are an ordinary category of expense included in the revenue requirement for a utility under traditional cost of service ratemaking principles. *Unitil Energy Systems, Inc.,* Order No. 24,449, 90 NH PUC 133, 136 (April 7, 2005). Changes in pension-OPEB costs due to market fluctuations are expected and will impact earnings from year to year, both positively and negatively. The Company may file a rate case if it believes it is significantly under-earning, just as Staff or other parties may request an investigation in the event of a perceived over-earning, at which time a full examination of all income and expenses [*sic*] items would be undertaken.

EnergyNorth Natural Gas, Inc. d/b/a National Grid NH, Docket No. DG 08-009, Order No. 24,972 at 51.

Q. The Company states that "Depending on the uncertainty related to the timing of rate cases, rates can grossly over or under collect funds related to pension and OPEB expense. This is unfair to both customers and the Company."[9] Do you agree with the Company's conclusion that the current ratemaking approach is unfair to both customers and the Company?

A. No. In the last rate case, I provided testimony recommending $2.6 million for pension and OPEB costs.[10] My testimony was based on the traditional ratemaking approach and included known and measurable adjustments to test year data. Specifically, I calculated certain adjustments to test year amounts for periodic pension and OPEB expenses based on the most recent actuarial report. With respect to allocated service company costs and other pension and OPEB amounts, I reviewed historical data to determine if any adjustments might be reasonable.

Q. In your opinion, did the amount you recommended in that case for pension and OPEB costs turn out to be reasonable in terms of the amounts actually incurred by EnergyNorth?

A. Yes. In fact, the amounts I recommended were conservative, *i.e.*, greater than the amounts actually incurred by EnergyNorth. My recommended level of pension and OPEB expense of $2.6 million pertained to the period beginning August 24, 2008, the effective reconciliation date for permanent rates. By comparison, the actual pension and OPEB costs incurred by EnergyNorth for the fiscal year ended

[9] Source: Testimony of Lombard and Adams, page 25 of 51, lines 19-21.
[10] Reference Testimony of James J. Cunningham Jr., October 31, 2008, Schedule JJC-2.

March 2008 totaled $2.4 million; and, for fiscal year ended March 2009, the actual pension and OPEB costs incurred by EnergyNorth totaled $2.5 million.[11] Based on the above, the use of traditional ratemaking appears to have produced a reasonable outcome.

Q. The Company argues for a reconciling mechanism because of numerous actuarial and other assumptions stating: "unlike most other expenses, where the Company books an actual cost that it incurs, with regard to pension and OPEBs, the Company is required by financial accounting standards to book an accrual that is based on numerous actuarial and other assumptions."[12] Do you believe the Company's argument is reasonable?

A. No. Financial accounting standards for pension and OPEB accruals are similar to depreciation accounting standards in that both require numerous assumptions. With respect to pensions and OPEBs, the Company engages an actuarial firm that utilizes various assumptions relating to employee turnover, retirement age, life expectancy, etc., to prepare an actuarial report. With respect to depreciation accruals, the Company performs a similar exercise, *i.e.*, it hires a consultant to determine depreciation accrual rates based on numerous factors including average service lives, availability of company-specific accounting data, technological changes, changes in Company accounting practices and changes in government regulations, etc. In spite of the numerous factors pertaining to calculating depreciation accrual rates, the Company's depreciation expense continues to be

[11] Source: Testimony of Lombardo and Adams, page 24 of 51, lines 9-11.
[12] Source: Testimony of Lombardo and Adams, page 25 of 51, lines 6-9.

based on the traditional ratemaking approach, *i.e.*, depreciation accrual rates are periodically updated in the context of a rate case filing. I believe pensions and OPEBs expense should also continue to be based on the traditional ratemaking approach.

Q. The Company argues for a reconciling mechanism because the amounts are significant, stating: "Pension and OPEB expenses are a significant expense for the Company. The actual test year expense was $1,995,447 for pensions and $1,019,805 for OPEBs, which combined represent approximately 12% of total non-commodity O&M expense."[13] Do you agree that the significant expense warrants the proposed reconciling mechanism?

A. No. With respect to the significance of pension and OPEB amounts, I note that depreciation expense is approximately $8.0 million[14] in the *pro forma* test year, 32 percent of total non-commodity O&M Expense. In spite of the magnitude of depreciation expense, the Company is not seeking a reconciling mechanism for depreciation expense; rather, the Company utilizes the traditional ratemaking approach to set depreciation accrual rates.

[13] Source: Testimony of Lombardo and Adams, page 23 of 51, lines 20 to page 24 of 51, line 1.
[14] Source: Filing, Exhibit EN 2-2-1A, line 3.

Q. EnergyNorth argues for a reconciling mechanism due to volatility and uncertainty related to the timing of rate cases. The Company states: "…amounts recorded on a company's books for pension and OPEBs vary significantly from year to year."[15] Please comment.

A. Based on actual and forecast amounts, the Company's argument is not persuasive. With respect to actual amounts, over the past 5 years, the only fiscal year that shows a significant change was fiscal year 2008. In that year, the actual amount incurred was $2.4 million, a reduction of $0.9 million from the $3.3 million incurred in fiscal year 2007. In all other years, the amounts remained essentially unchanged from prior year. That is, in fiscal year 2005 EnergyNorth actually incurred $3.3 million in pension and OPEBs expense. In fiscal year 2006, the Company actually incurred $3.2 million. In fiscal year 2007, the actual amount incurred was $3.3 million. As noted above, for fiscal years 2008, the amount decreased to $2.4 million and it remained at that level for fiscal year 2009. With respect to projected amounts for pensions and OPEBs for the next 5 years, the filing indicates that only fiscal year 2010 shows a significant change, from $2.5 million actually incurred in fiscal year 2009 to a forecast of $4.0 million in 2010. After fiscal year 2010, the forecast amounts level off at or near $4.0 million. Specifically, EnergyNorth is projecting $4.1 million for fiscal years

[15] Source: Testimony of Lombardo and Adams, page 25 of 51, lines 18-21.

2011, $4.0 million for fiscal year 2012, $4.0 million for fiscal year 2013 and $3.9 million and $3.7 million for fiscal year 2014 and fiscal year 2015, respectively.[16] Based on the above, the argument that pension and OPEB expense is volatile is not persuasive. Over the past ten years, eight of the ten years show zero or little change in the annual amount of pension and OPEB expense. Further, in fiscal year 2015, EnergyNorth projects that its pension and OPEB expense will be $3.7 million, only $400 thousand greater than actually incurred ten years earlier, in fiscal year 2005.

Q. EnergyNorth argues for a reconciling mechanism due to factors beyond management's discretion stating: "Due to many factors beyond management's discretion, it is likely that during the period in which rates are in effect that pension and OPEB expenses will be either significantly greater or less than the test year amounts."[17] Do you agree?

A. No. Although there are economic forces beyond the company's control, such as equity markets, tax law changes and changes in financial accounting standards which a utility is required to implement, the Company nevertheless retains control of the plan's design and projected salary increases. Also, the Company retains a certain amount of control regarding the level of cash contributions to be made.

[16] Source: Testimony of Lombardo and Adams, page 24 of 51, lines 9-11.
[17] Source: Testimony of Lombardo and Adams, page 24 of 51, lines 1-3.

Q. Do you believe that the Company has made a case for its proposed reconciling mechanism?

A. No. As stated, EnergyNorth argues for its proposed reconciling mechanism based on: (1) timing of rate cases; (2) actuarial and other assumptions; (3) significance; (4) volatility; and (5) factors beyond management's discretion. In my view, the arguments put forward by the Company are not persuasive.

Q. Please summarize your recommendations pertaining to the EnergyNorth's proposal for a reconciling mechanism.

A. I recommend that the Commission not approve the proposed reconciling mechanism included in the LDAC. Rather, I recommend continuation of the current practice of addressing pension and OPEB expenses as part of an overall review of revenue and expenses in the context of the Company's periodic rate case filings. I believe the current ratemaking approach, including known and measureable adjustments to test year amounts, is appropriate and should be retained.

Q. **Do you have any general concerns regarding potential future implications if the Company's proposal for a reconciling mechanism were approved?**

A. Yes. If the Company's proposal for a reconciling mechanism for pensions and OPEBs were approved by the Commission, I would expect there would be a host of other similar filings in the future for pension and OPEB reconciling mechanisms as well as for other reconciling mechanisms that, due to the particular circumstances of the individual company, might be deemed by a company to be “volatile” or “due to factors beyond management’s discretion”. I think once these lines are crossed, the Commission will have a difficult time determining at what point a particular cost becomes too volatile or due to factors beyond management’s discretion.

Q. Do you have any other comments?

A. No.

Q. Does that complete your testimony?

A. Yes, it does, thank you.