Phillip Russell (10445)
JAMES DODGE RUSSELL & STEPHENS, P.C.
10 West Broadway, Suite 400
Salt Lake City, UT 84101
Telephone: 801-363-6363
Facsimile: 801-363-6666
Email: prusell@jdrslaw.com

Attorneys for the UAE Intervention Group

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE APPLICATION OF DOMINION ENERGY UTAH TO INCREASE DISTRIBUTION RATES AND CHARGES AND MAKE TARIFF MODIFICATIONS	**Docket No. 22-057-03**

PREFILED DIRECT TESTIMONY OF KEVIN C. HIGGINS

The UAE Intervention Group (UAE) hereby submits the Prefiled Direct Testimony of Kevin C. Higgins.

DATED this 26th day of August, 2022.

By: Phillip J Russell
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CERTIFICATE OF SERVICE
Docket No. 22-057-03

I hereby certify that a true and correct copy of the foregoing was served by email this 26th day of August, 2022, on the following:

QUESTAR GAS COMPANY

Jenniffer Nelson Clark	jenniffer.clark@dominionenergy.com
Cameron Sabin	csabin@mayerbrown.com

DIVISION OF PUBLIC UTILITIES

Chris Parker	chrisparker@utah.gov
William Powell	wpowell@utah.gov
Madison Galt	mgalt@utah.gov
Patricia Schmid	pschmid@agutah.gov
	dpudatarequest@utah.gov

OFFICE OF CONSUMER SERVICES

Michele Beck	mbeck@utah.gov
Bela Vastag	bvastag@utah.gov
Alyson Anderson	akanderson@utah.gov
Alex Ware	aware@utah.gov
Robert Moore	rmoore@agutah.gov
	ocs@utah.gov

FEDERAL EXECUTIVE AGENCIES

Maj. Holly L. Buchanan	holly.buchanan.1@us.af.mil
Thomas A. Jernigan	thomas.jernigan.3@us.af.mil
Capt. Marcus Duffy	marcus.duffy.3@us.af.mil

NUCOR STEEL-UTAH

Damon E. Xenopoulos	dex@smxblaw.com
Laura W. Baker	lwb@smxblaw.com

AMERICAN NATURAL GAS COUNCIL, INC.

Stephen F. Mecham	sfmecham@gmail.com
Curtis Chisholm	cchisholm@ie-cos.com

/s/ *Phillip J. Russell*

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

Phase I Direct Testimony of Kevin C. Higgins

on behalf of

UAE

Docket No. 22-057-03

August 26, 2022

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EXHIBITS

DIRECT TESTIMONY OF KEVIN C. HIGGINS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Kevin C. Higgins. My business address is 111 East Broadway, Suite 1200, Salt Lake City, Utah, 84111.

Q. By whom are you employed and in what capacity?

A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies is a private consulting firm specializing in economic and policy analysis applicable to energy production, transportation, and consumption.

Q. On whose behalf are you testifying in this proceeding?

A. My testimony is being sponsored by the Utah Association of Energy Users Intervention Group ("UAE").

Q. Please describe your professional experience and qualifications.

A. My academic background is in economics, and I have completed all coursework and field examinations toward a Ph.D. in Economics at the University of Utah. In addition, I have served on the adjunct faculties of both the University of Utah and Westminster College, where I taught undergraduate and graduate courses in economics. I joined Energy Strategies in 1995, where I assist private and public sector clients in the areas of energy-related economic and policy analysis, including evaluation of electric and gas utility rate matters.

Prior to joining Energy Strategies, I held policy positions in state and local government. From 1983 to 1990, I was economist, then assistant director, for the Utah Energy Office, where I helped develop and implement state energy policy. From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County Commission, where I was responsible for development and implementation of a broad spectrum of public policy at the local government level.

Q. Have you previously testified before this Commission?

A. Yes. Since 1984, I have testified in 45 dockets before the Utah Public Service Commission on electricity and natural gas matters.

Q. Have you testified previously before any other state utility regulatory commissions?

A. Yes. I have testified in approximately 225 other proceedings on the subjects of utility rates and regulatory policy before state utility regulators in Alaska, Arizona, Arkansas, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Missouri, Montana, Nevada, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas, Virginia, Washington, West Virginia, and Wyoming. I have also filed affidavits in proceedings at the Federal Energy Regulatory Commission and prepared expert reports in state and federal court proceedings involving utility matters.

II. OVERVIEW AND CONCLUSIONS

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

A. My testimony addresses certain revenue requirement issues in this general rate case. As part of my testimony, I make recommendations to adjust the revenue requirement proposed by Dominion Energy Utah ("DEU").

Q. What revenue increase is DEU recommending?

A. In its direct filing, DEU is proposing a revenue increase of $70,511,689, or 15.93% on an annual basis.[1]

Q. Please summarize the revenue requirement adjustments you are recommending.

A. My recommended adjustments reduce DEU's revenue requirement by a total of $39,865,719 relative to DEU's proposed revenue requirement increase of $70,511,689. This reduction includes an illustrative reduction to DEU's requested return on equity ("ROE") from 10.30% to 9.50%, which is the median ROE approved by state regulators in the United States for natural gas distribution utilities as reported by S&P Global Market Intelligence for the 12-month period ending July 31, 2022. I included this adjustment as a placeholder because UAE anticipates that the Division of Public Utilities ("Division"), the Office of Consumer Services ("Office"), and possibly other parties will fully address cost of capital in their respective testimonies, and their recommendations will be given significant weight by the Commission.

[1] *See* DEU Exhibit 4.09, p. 2.

My adjustments are presented in Table KCH-1 below. My recommended adjustments are as follows:

1) I incorporate a correction to DEU's operation & maintenance ("O&M") expense identified in discovery.[2] This adjustment increases the Utah revenue requirement by **$1,004,579**.

2) DEU's proposed labor O&M expense should be reduced because it is based on a budgeted full-time equivalent ("FTE") employee count that is greater than the actual FTE count. I recommend basing test year labor expense on the average actual FTE count during the 13-months ended June 2022. This adjustment reduces the Utah revenue requirement by **$1,642,234**.

3) DEU proposes to set pension expense to zero for ratemaking purposes, even though pension cost calculated pursuant to Financial Accounting Standards ("FAS") is actually projected to be ($21,121,355) in 2023, *i.e.*, a negative value or credit.[3] I recommend against setting pension expense to zero for ratemaking purposes in this case. Instead, pension expense should be set using the projected FAS cost for 2023. This adjustment reduces the Utah revenue requirement by **$23,887,726** and is calculated assuming that 50% of DEU's pension service cost is capitalized.

[2] *See* DEU Response to UAE Data Request 4.02, included in UAE Exhibit RR 1.6.
[3] *See* DEU Response to UAE Data Request 1.09, included in UAE Exhibit RR 1.6. The use of paratheses around values in this testimony denotes a negative number.

4) I recommend that a regulatory liability be established for the gain on the sale of DEU's Bluffdale Field Office and amortized over 5 years beginning in August 2020. This adjustment reduces the Utah revenue requirement by **$518,046**.

5) I recommend that the capitalized incentive compensation related to financial goals be excluded from rate base in this case for 2021, 2022 and 2023 capital additions. This adjustment reduces the Utah revenue requirement by approximately **$332,689**. Going-forward, I recommend that the Commission establish a policy that the capitalized portion of financially-related incentive compensation be borne by shareholders rather than customers, consistent with the treatment of the expense portion of these costs.

6) I present an illustrative revenue requirement adjustment that incorporates an ROE of 9.50% rather than the 10.30% ROE requested by DEU. My illustrative ROE uses the median ROE for natural gas distribution utilities approved by state regulators in the United States in the past year as reported by S&P Global Market Intelligence. The Utah revenue requirement reduction from such an adjustment is **$14,489,603** relative to the Company's filed case.

7) If the Commission approves the continuation of the Infrastructure Tracker Program, I recommend that annual expenditures be capped at no more than $77.4 million *without* future adjustments for inflation in order to provide reasonable cost containment for the tracker mechanism.

Table KCH-1
UAE Revenue Requirement Adjustments

Adjustment Description	UT Jurisdiction Adjustment Impact	UT Jurisdiction Deficiency
DEU Requested Increase		$70,511,689
O&M Error Correction	$1,004,579	$71,516,268
FTE Labor Adjustment	($1,642,234)	$69,874,034
Pension Expense Adjustment	($23,887,726)	$45,986,308
Gain on Sale Adjustment	($518,046)	$45,468,263
Capitalized Financial Incentive Comp Adj.	($332,689)	$45,135,573
Return on Equity Adjustment *	($14,489,603)	$30,645,970
Total UAE Adjustments	($39,865,719)	
UAE Recommended Increase		$30,645,970

* Reflects illustrative ROE adjustment

III. REVENUE REQUIREMENT

O&M Expense Correction & Forecasting Process

Q. Please describe the O&M expense correction you have incorporated into your revenue requirement adjustments.

A. In discovery, DEU explained that its O&M expenses contained several errors which, if corrected, increase the Utah revenue requirement by **$1,004,579**.[4] I have incorporated this correction in Table KCH-1, above, so that my subsequent adjustments are not impacted by this error.[5]

[4] *See* DEU Response to UAE Data Request 4.02, included in UAE Exhibit RR 1.6.
[5] Since DEU did not indicate which specific FERC accounts were impacted by its error, I adjusted Accounts 887 and 923 in 22-057-03 UAE Direct RR Model, PROJECTED EXPENSES tab, as well as the 2021 affiliated O&M expenses on the Labor Forecast tab, in order to produce the impact stated in DEU Response to UAE Data Request 4.02.

Q. Before turning to your recommended adjustments, do you have any concerns with the general approach DEU used to calculate the labor O&M expenses in its revenue requirement?

A. Yes. Based on my experience, DEU's approach to calculating its labor O&M expenses differs from the standard practice used by most regulated utilities in general rate cases. The standard approach starts with actual costs incurred during an historical base period, and discrete adjustments are typically made to those actual costs based on known and measurable changes. The adjustment calculations are normally reviewed and potentially challenged by parties to the case in order to ensure that the test year is a proper representation of the utility's costs.

For example, in Rocky Mountain Power's last rate case, test year wages were calculated starting with actual data from the base period, escalated using contracted and anticipated percentage wage increases.[6]

This standard approach is the one that DEU witness Mr. Jordan K. Stephenson *asserts* that DEU has taken in this docket:

> The Company proposes to use as the base period the 13-month period ending December 31, 2021. This constitutes the Company's most recent full calendar year of actual revenues, expenses, and rate base balances that will serve as the foundational starting point for the revenue requirement calculation.[7]

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[6] *See* Docket No. 20-035-04, Rebuttal Testimony of Steven R. McDougal, lines 295-318, Exhibit RMP__(SRM-2), pp. 10.11.3 - 10.11.5. In that case, UAE recommended adjustments to reflect the wage levels in effect during the months of the test year as well as a lower employee count, which were accepted by Rocky Mountain Power in rebuttal.

[7] Direct Testimony of Jordan K. Stephenson, lines 102-105.

However, in contrast to the standard approach, and to the general approach DEU claims to have taken in this docket, DEU's labor O&M expenses are based on a 2022 *budget* with adjustments to forecast the 2023 test year expenses. DEU describes this process in response to UAE Data Request 1.05, which sought information about pasted values in DEU's labor forecast documents. DEU's response states as follows:

> The Labor Forecast is prepared in Hyperion. Budget managers enter employee salaries, new hires, replacements, labor hours and capitalized percentages into a worksheet. A sample worksheet was submitted as MDR_22 D.13 Attach 3A.xls.
>
> Gross benefit amounts are also entered into Hyperion. Hyperion then calculates labor costs (based upon salary and hours), assigns accounts, and spreads benefits costs to the various departments. A Hyperion report is then generated to provide the detailed budget data (account, cost center and month) to load into the SAP Financial system. The detail referred to in the question is a direct output from the Hyperion program.[8]

Q. Why are you concerned with DEU's approach to calculating its labor O&M expenses?

A. DEU's approach does not provide the transparency required to verify the accuracy or reasonableness of the labor expenses included in its proposed revenue requirement. Rather than making discrete adjustments to the historical 2021 base period, the foundation for DEU's labor costs is a 2022 budget from Hyperion, which is then escalated by 3% for most cost categories to calculate a 2023 forecast.[9]

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[8] DEU Response to UAE Data Request 1.05 is included in UAE Exhibit RR 1.6.
[9] DEU's 2023 labor O&M expense forecast also includes a headcount adjustment.

Q. How do the Company's forecasted labor expenses compare to its actual 2021 labor expenses?

A. These results are summarized in Table KCH-2, below. Excluding the pension expense component, DEU's 2023 labor expense forecast is 13.8% higher than its actual 2021 labor expenses (after taking account of the error identified by DEU noted at the beginning of this section).

Table KCH-2
Comparison of DEU Actual & Forecast Labor Expenses[10]

Labor Expense Components	2021 Actual	2022 Budget	2023 Forecast
Base Labor Expense	34,910,041	36,405,071	38,045,656
Incentive Accrual Expense [11]	4,605,638	3,530,596	3,636,514
Other Expense	176,292	303,194	304,510
Total DEU Labor Expensed	39,691,972	40,238,861	41,986,680
Other Labor Overhead Expense	6,027,748	6,639,450	6,838,634
Affiliated Labor (560)	22,120,541	25,405,972	26,168,152
Affiliated Labor Overhead (561)	10,847,659	14,122,327	14,545,997
Total Labor/Labor Overhead Expensed	78,687,920	86,406,611	89,539,462
Year-to-Year % change	8.10%	9.81%	3.63%

As shown in Table KCH-2, DEU is forecasting significant increases in its labor expense, particularly when comparing the 2022 budget to the 2021 actual expense. These increases are especially concerning in the absence of workpapers from DEU demonstrating the nexus between its 2022 budget and actual expenses incurred in 2021.

[10] Based on DEU Exhibit 3.06, with the correction to 2021 affiliated labor described in DEU Response to UAE Data Request 4.02. Pension expense is excluded.
[11] Does not include the impact of DEU's adjustment to remove financially-related incentive compensation expense.

Q. What is your recommendation to the Commission on this issue?

A. I recommend that DEU be required to demonstrate it its next general rate case that its test year O&M expenses are based on actual historical base period expenses with known and measurable test year adjustments. These adjustments should be prepared in Excel format based on discrete changes between the base period and test year with explanatory testimony provided by DEU. The Company is, of course, free to use proprietary software for its internal O&M budgeting purposes but such forecasts should not be the basis for its regulated revenue requirement.

My recommended adjustment to labor expense is based on employee count and is described in the following section of my testimony. I apply that adjustment to DEU's 2023 forecasted labor expense. I consider my adjustment to be conservative, given the insufficient evidence provided by DEU for its test year labor O&M forecast.

Employee Count

Q. Please describe the basis for your adjustment to labor O&M expenses based on employee count.

A. DEU's test year labor O&M expenses are based on a forecasted full-time equivalent (FTE) employee count that is 5.9% higher than the average actual FTE employee count experienced in 2021.[12] Looking at a more recent period, the average actual FTE count for the 13 months ended June 2022 is 919.3 FTE

[12] See UAE Exhibit RR 1.1, p. 2.

employees, which is 35.7 fewer than DEU's forecasted 2023 employee count of 955 FTE employees.[13]

Q. What is your recommendation regarding the appropriate FTE count for setting DEU's labor O&M expense in this case?

A. I recommend that test year labor expense be based on the average actual FTE count for the recent 13-month period ended June 2022,[14] which better reflects DEU's actual employment level than DEU's forecast. Accordingly, I have reduced labor O&M expenses to account for a reduction of 35.7 FTEs compared to DEU's 2023 forecast. I have derived this adjustment by reducing labor O&M expenses to reflect an FTE employee count that is approximately 3.7% lower than DEU's forecast, for cost categories likely to be impacted by the number of employees.

Q. Why do you believe it is appropriate to base DEU's labor expenses on the average FTE count for the year ended June 2022 instead of its forecast?

A. My adjustment is intended to reflect the most accurate employment level for setting rates. As shown in DEU's response to UAE Data Request 1.08, the Company's budgeted employment level has typically exceeded its actual employment level since at least January 2020. To be clear, I am not advocating that a particular number of employees is appropriate for DEU, nor am I suggesting that the Commission "micro-manage" the Company. It is up to DEU

[13] Based on DEU Response to UAE Data Request 1.08, Attachment 1, included in UAE Exhibit RR 1.6.
[14] The June 2022 FTE count is the most recent information provided to me by DEU at the time my testimony is filed.

to manage its employment level to operate efficiently and safely. My adjustment is simply intended to compensate the Company for a realistic level of labor expense based on the best available information at this time.

Q. What is the revenue requirement impact of your employee count adjustment?

A. The impact of my employee count adjustment is shown in UAE Exhibit RR 1.1. It reduces the Utah revenue requirement by **$1,642,234**.

Pension Expense

Q. By way of introduction, how do utilities generally recover their pension costs?

A. In my experience, most utilities are afforded recovery of the cost of their qualified pension plans based on the "net periodic pension cost" included in the revenue requirement in general rate cases. The net periodic pension cost is the amount recognized in an employer's financial statements as the cost of a pension plan for a period under Generally Accepted Accounting Principles established by the FAS Board ("FASB"). For ratemaking purposes, net periodic pension cost is generally comprised of pension expense (i.e., pension costs being expensed during a rate case test period) and capitalized pension cost (i.e., pension cost that is not expensed in the rate case test period but is included in rate base).

Q. Are an employer's annual cash expenditures for its pension plans and net periodic pension costs the same?

A. Generally, no. Employer contributions often differ from the net periodic pension cost recognized in any given year, although over the life of the pension plan, the total employer contributions and the cumulative net periodic pension cost are equal.

The actual amount the Company contributes to its pension plans each year is a corporate policy decision that is subject to federal statutes. These statutes govern the maximum contribution that can be immediately deducted for tax purposes and the minimum contribution required to satisfy plan funding rules. The Company has discretion over the actual amount contributed to its pension plans each year subject to these statutes.

Q. What is DEU's projected 2023 net periodic pension cost?

A. DEU's total projected 2023 net periodic pension cost is ($21,121,355), *i.e.*, a negative value or credit. [15]

Q. How can pension cost be negative?

A. Net periodic pension cost includes several actuarially-determined cost components such as the service cost, interest cost, and the amortization of prior service costs and actuarial losses/gains, which are offset by the expected return on plan assets. While the concept of negative pension costs might seem at first to be

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[15] *See* DEU Response to UAE Data Request 1.09, Attachment 1, included in UAE Exhibit RR 1.6. I note that the cited amount provided by DEU is the stand-alone cost for Questar QGC, whereas Dominion Energy, Inc.'s financial statements are reported on a consolidated basis.

counterintuitive, they can occur when the expected return on plan assets is greater than the service cost, interest cost, and amortizations.

Q. What is the expense portion of DEU's 2023 pension cost?

A. Of the total projected 2023 net periodic pension cost of ($21,121,355), DEU indicates that the expense portion is ($10,044,611).[16] This means that DEU anticipates capitalizing approximately 52% of its total pension cost.

However, DEU's presentation of the expense portion of its pension cost does not appear to comport with FASB's rules. FASB's Accounting Standards Update No. 2017-07 limits the portion of net periodic pension cost eligible to be capitalized to the *service cost* component only.[17]

DEU's total projected 2023 net periodic pension cost of ($21,121,355) is comprised of a service cost of $6,953,800 and other components totaling ($28,075,155).[18] This means that the amount eligible to be capitalized under FASB's rules is the *positive* service cost of $6,953,800. Assuming that approximately 50% of the service cost is capitalized, I estimate that the capitalized portion of DEU's projected 2023 pension cost is $3,476,900 and the remaining expense portion is ($24,598,255).

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[16] These are Total System amounts. The Utah-jurisdictional portion of DEU's projected 2023 pension expense is ($9,719,864). *See* DEU Exhibit 4.20 Summers Testimony - Electronic Model 5-2-2022 Pension tab.

[17] *See* Accounting Standards Codification 715-30-35-7A, accessible using Basic View at https://asc.fasb.org/: "The service cost component shall be the only component of net periodic pension cost eligible to be capitalized as part of the cost of inventory or other assets."

[18] *See* DEU's Response to UAE Data Request 1.09, Attachment 1, included in UAE Exhibit RR 1.6.

Q. What has DEU proposed regarding the treatment of qualified pension expense?

A. DEU proposes to set pension expense to zero for ratemaking purposes. The Company first proposed this treatment in its last general rate case, Docket No. 19-057-02, in which DEU removed the projected 2020 pension expense of ($5,448,127) from the revenue requirement.[19] This treatment was approved by the Commission in Docket No. 19-057-02.[20]

Q. What reason did DEU provide in Docket No. 19-057-02 for excluding the pension expense from the revenue requirement?

A. In that case, Mr. Stephenson explained that Dominion Energy shareholders contributed $75 million to the DEU pension plan in 2017. Mr. Stephenson attributed the negative pension expense to the cash contribution made by shareholders and asserted that it is appropriate to set the pension expense to zero rather than reflect a credit to customers in the revenue requirement.[21]

Q. Do you agree that qualified pension expense should be removed from the revenue requirement?

A. Such a treatment would only be appropriate if pension expense were eliminated from ratemaking on a permanent basis. However, it would not be equitable to deprive customers of a credit in rates when pension costs are negative but include pension expense in rates if pension costs are positive in the future.

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[19] Docket No. 19-057-02, DEU Exhibit 3.30.
[20] Docket No. 19-057-02, Report and Order Issued February 25, 2020, pp. 20-21.
[21] Docket No. 19-057-02, Direct Testimony of Jordan K. Stephenson, lines 522-544.

Q. Has DEU committed to permanently excluding pension expense from rates?

A. No. In fact, it appears that the Company proposes to include the cost of its nonqualified pension plans in rates.[22] Nonqualified pension plans generally apply to a select group of highly-compensated employees whose compensation exceeds the limits provided by tax law for deducting pension-related expense.[23] According to discovery, DEU's budgeted 2023 expense for these nonqualified retirement plans is $250,000.[24]

Q. Why do you believe that it would be unreasonable to set qualified pension expense at zero in this case but include pension expense in rates if pension costs are positive in the future?

A. By definition, over the life of a pension plan, the cumulative sum of FAS pension cost (including negative pension cost) will equal the cumulative sum of the Company's funding contributions. This means that setting customer pension cost responsibility in rates equal to FAS pension cost ensures that, by and large,[25] customer rates will fully fund the pension plan costs over the life of the plan. Selectively "zeroing out" pension expense in rates when pension cost is negative as proposed by DEU will cause customers to overpay for pension cost over the life of the pension plan. Such a result would not be reasonable. Therefore, I

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[22] *See* DEU Responses to OCS Data Requests 2.54 and 8.42, included in UAE Exhibit RR 1.6.

[23] In 2021, 22 of DEU's employees were eligible for its nonqualified pension plans. *See* DEU Response to OCS Data Request 2.56, included in UAE Exhibit RR 1.6.

[24] *See* DEU Response to OCS Data Request 8.42.

[25] Since FAS pension cost changes annually, and base rates are not reset every year, the cumulative pension cost *in rates* will likely not exactly match the cumulative sum of funding contributions over the life of the plan.

recommend against setting pension expense to zero for ratemaking purposes in this case.

Q. How can it be reasonable to recognize negative pension expense in rates when negative pension expense does not actually provide any funds to the Company?

A. Determining the appropriate revenue requirement involves considerations beyond cash funding to the utility. Ratemaking also imputes certain costs to customers that are non-cash items, such as depreciation expense, as well as recovers income tax expense from customers based on book depreciation rather than the accelerated depreciation that is the basis of the income taxes that utilities actually pay.

A comparable situation exists with respect to pension costs. In general, the pension costs assigned to customers for recovery in a rate case are delinked from the actual cash expenditures by the utility in the test period. Customers are generally expected to pay for the utility's FAS pension cost for the test period, which is an accounting determination, irrespective of whether the utility makes any cash contributions to its pension plan in the test period. The consistent application of this principle ensures that customers fully recover the cost of the utility's pension plan over the life of the plan. The upshot is that when pension cost is positive and is included in the revenue requirement, it no more represents a cash cost to the utility than a negative pension cost represents a cash benefit to the utility. Recognizing negative pension expense in the revenue requirement simply maintains consistency with the practice of using FAS accounting to determine the pension cost included in the revenue requirement.

I acknowledge, based on the Commission's decision in the last DEU rate case, that the Commission may be reluctant to recognize a negative pension cost in the DEU revenue requirement. However, unless customers are similarly released from the obligation to pay for positive FAS pension costs in the future, I continue to maintain that recognition of the negative pension cost in rates is appropriate.

Q. Mr. Stephenson indicates that as part of its pension adjustment, DEU excluded a pension asset from rate base.[26] Do you wish to comment on this element of DEU's proposal?

A. Yes. DEU indicates that it has excluded from rate base a $135.9 million "deferred pension asset," offset by $42.6 million of accumulated deferred income tax ("ADIT"), for a net asset of $93.3 million.[27] While DEU does not clearly define the nature of this pension asset, it appears to represent a prepaid pension asset.

Prepaid pension assets represent the difference between a utility's cumulative contributions to its pension plan (since the inception of the plan) and the cumulative FAS pension cost since the inception of the plan. If the difference is positive, this amount is construed to be a prepaid pension asset. If the difference is negative, it is construed to be an accrued pension liability. In some

[26] Direct Testimony of Jordan K. Stephenson, lines 525-527.
[27] DEU Exhibit 4.20 Summers Testimony - Electronic Model 5-2-2022 Pension tab.

jurisdictions, utilities are permitted to include prepaid pension assets in rate base. In other jurisdictions, such as Oregon and Utah, they are not.

To the best of my knowledge, Utah has never approved the inclusion of a prepaid pension asset in rate base. The Commission rejected Rocky Mountain Power's proposal to include its prepaid pension and postretirement welfare assets in rate base in its last rate case, Docket No. 20-035-04.[28]

For that reason, I do not believe it is correct to view DEU's adjustment as having "excluded" the pension asset from rate base, since I do not believe we can consider the pension asset as having been included in rate base in the first place.

Q. Do you believe a pension asset should be recognized in DEU's rate base in this case?

A. No. Recognition of a pension asset in rate base is an important policy decision with significant long-term ramifications. It should not be undertaken without a thorough examination of all the implications. The existence and size of a prepaid pension asset can be affected by a number of factors, such as discretionary contributions by the Company and expected and actual performance in the market of the Company's pension portfolio. I see no reasonable basis for these factors to be a cause for customers to be required to pay DEU a return on any prepaid pension asset.

Furthermore, if a prepaid pension asset were considered for inclusion in rate base, it would be necessary to account for the impact on the asset of setting

[28] Docket No. 20-035-04, Order Issued December 30, 2020, pp. 36-37.

pension expense to $0 in any preceding rate case, despite net periodic pension costs being negative. Otherwise, the amount of the prepaid pension asset would be inflated from a regulatory standpoint.

Q. Please summarize your recommendations regarding DEU's pension costs.

A. I recommend against setting pension expense to zero for ratemaking purposes in this case. My adjustment includes the projected 2023 pension expense of ($24,598,255) in the revenue requirement, which assumes that 50% of the service cost is capitalized. This adjustment may require refinement if DEU produces more information on its expected capitalized amount and demonstrates that its capitalization treatment is in accordance with FASB rules. I also recommend against including DEU's prepaid pension asset in rate base.

In the alternative, if the Commission determines that pension expense should be set to zero in this case, I recommend that any positive pension expense also be excluded from the revenue requirement in future rate cases. I also recommend that DEU not be permitted to add any capitalized portion of its pension service cost to rate base on a going-forward basis.

Q. What is the revenue requirement impact of your pension adjustment?

A. The impact of my pension adjustment is shown in UAE Exhibit RR 1.2. It reduces the Utah revenue requirement by **$23,887,726**.

Gain on Sale of Bluffdale Field Office

Q. Has DEU realized any gains on the sale of utility property in recent years?

A. Yes, according to discovery, the Company sold its Bluffdale Field Office on August 12, 2020 for net proceeds of $3,047,347.75. At the time, the property had a net book value of $714,582.71, resulting in a gain of $2,332,765.04, which was recorded to account 421.1 (Gain on disposition of property). The building was constructed in 1998 at a cost of approximately $900,000 and was included in rate base.[29] The Bluffdale Field Office has been retired and removed from rate base.[30]

Q. What is your recommended ratemaking treatment of the gain on the sale of the Bluffdale Field Office?

A. I recommend that the gain on this sale be included in the revenue requirement as a credit to customers. This property was formerly included in rate base as utility property and the gain on the sale should benefit ratepayers. Specifically, I recommend that the gain on the sale be recorded as a regulatory liability, with offsetting ADIT, and amortized over five years beginning in August 2020.

Q. Since you are recommending that the amortization begin in August 2020, what will happen to the amortization that has already occurred prior to the proposed January 1, 2023 rate effective date?

A. Under my proposal, the portion of the gain that has already amortized prior to the rate effective date will be retained by DEU's shareholders as a function of regulatory lag. This means that DEU's shareholders will effectively retain nearly

[29] DEU Response to OCS Data Request 2.16, included in UAE Exhibit RR 1.6.
[30] DEU Response to OCS Data Request 8.32, included in UAE Exhibit RR 1.6.

half of the gain on the sale due to the time that has elapsed between the sale and the rate effective date.

Q. What is the revenue requirement impact of your gain on sale adjustment?

A. The impact of my adjustment is shown in UAE Exhibit RR 1.3. It reduces the Utah revenue requirement by **$518,046**.

Capitalized Financially-Related Incentive Compensation

Q. Does DEU make an adjustment to remove the incentive compensation expense associated with Company financial goals?

A. Yes, according to Mr. Stephenson's Direct Testimony, DEU removed the incentive compensation expense related to net income, earnings-per-share, and ROE goals either paid directly by Dominion Energy or allocated from Dominion Energy Services, Inc. for incentive payouts. Mr. Stephenson states that DEU's adjustment is in accordance with previous Commission orders in Docket Nos. 93-057-01, 95-057-02, 99-057-20 and 02-057-02.[31]

Q. Does DEU also remove from rate base the portion of incentive compensation related to financial goals that is capitalized?

A. Apparently not. According to discovery, DEU has not included a rate base adjustment for financially-related incentive compensation.[32]

[31] Direct Testimony of Jordan K. Stephenson, lines 447-451.
[32] DEU Response to OCS Data Request 8.38, included in Exhibit UAE RR 1.6.

Q. In your opinion, should capitalized financially-related incentive compensation be included in rate base?

A. No. The Company capitalizes approximately half of its directly-incurred incentive compensation cost.[33] These capitalized costs are added to rate base, earning a return and depreciating like other utility plant. It is not appropriate for ratepayers to bear the costs of financial compensation tied the Company's financial goals, whether these costs are expensed or capitalized.

Q. What do you recommend regarding capitalized financially-related incentive compensation?

A. I recommend that the capitalized incentive compensation related to financial goals be excluded from rate base in this case for 2021, 2022 and 2023 capital additions, with the test year amount calculated on an average-of-period basis. My adjustment uses the 2021 and 2022 financially-related incentive compensation expenses and Annual Incentive Plan capitalization percentage in DEU's workpapers[34] and the 2023 amount DEU provided in discovery.[35] My adjustment assumes that these amounts are capitalized evenly throughout the year and uses the depreciation rate from DEU's last Infrastructure Rate Adjustment Application as a proxy for the overall depreciation rate for the capitalized incentive compensation.[36] I recommend that the Commission order DEU to make any

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[33] DEU Exhibit 4.20 Summers Testimony - Electronic Model 5-2-2022, Incentive tab.
[34] DEU Exhibit 4.20 Summers Testimony - Electronic Model 5-2-2022, Incentive tab.
[35] DEU Response to OCS Data Request 8.38, included in Exhibit UAE RR 1.6.
[36] Depreciation rate of 1.93% based on rate used in DEU's Infrastructure Rate Adjustment Application, Docket No. 21-057-19.

necessary refinements to my adjustment to remove the financially-related incentive compensation capitalized since the last rate case from the revenue requirement.

Going-forward, I recommend that the Commission establish a policy that the capitalized portion of financially-related incentive compensation be borne by shareholders rather than customers, consistent with the treatment of the expense portion of these costs.

Q. What is the revenue requirement impact of your capitalized incentive compensation adjustment?

A. The impact of my adjustment is shown in UAE Exhibit RR 1.4. It reduces the Utah revenue requirement by approximately **$332,689**.

Return on Equity

Q. What ROE is DEU proposing?

A. DEU is proposing an ROE of 10.30%.[37] This return represents an increase of 80 basis points over the 9.50% ROE approved by the Commission in Docket No. 19-057-02[38] and the median ROE for natural gas distribution utilities approved by state regulators in the United States in the past year.

Q. Does UAE support DEU's request?

A. No. Please refer to UAE Exhibit RR 1.5, page 2, which lists the ROEs for natural gas distribution utilities approved by state regulators in the United States as

[37] *See* Direct Testimony of Jennifer E. Nelson, lines 1164-1166.
[38] Docket No. 19-057-02, Report and Order Issued February 25, 2020, p. 5.

reported by S&P Global Market Intelligence for the 12-month period ending July 31, 2022. The median ROE approved over these past 12 months was 9.50%. If DEU's ROE in this case were to be set at a rate reflective of the national median, it would be in the vicinity of 9.50%.

Q. In offering this discussion of national trends, are you intending to supplant the Commission's consideration of traditional cost-of-capital analysis?

A. No. I expect that the Division, the Office, and possibly other parties will file cost-of-capital analyses for the Commission's consideration, along with that filed by DEU. My discussion of national trends is intended to supplement that analysis. Based on my experience in other proceedings, I would not be surprised if other parties present credible analysis indicating that DEU's ROE should be set lower than 9.50%.

Q. What would be the revenue requirement impact if DEU's ROE were set at the national median of 9.50%?

A. The revenue requirement impact of setting DEU's allowed ROE at 9.50% is presented in UAE Exhibit RR 1.5, page 1. It reduces the Utah revenue requirement by approximately **$14,489,603** relative to DEU's filed case. As I discussed previously, I incorporated an ROE of 9.50% into UAE's overall revenue requirement recommendations for illustrative purposes, pending further information being presented into the record by other parties.

IV. INFRASTRUCTURE TRACKER PROGRAM

Q. What is the Infrastructure Tracker Program?

A. The Infrastructure Tracker Program was approved in Docket No. 09-057-16 on a pilot basis. As initially adopted, the program allowed DEU to use a tracker to recover, between rate cases, the incremental cost of replacing high-pressure feeder lines and related facilities by levying a pro rata surcharge on customer classes. Annual expenditures on program-eligible infrastructure were initially limited to $55 million on an inflation-adjusted basis.[39] In Docket No. 13-057-05 the cap was increased to $65 million plus an inflation adjustment and was expanded to include certain intermediate high-pressure beltlines.[40] In Docket No. 19-057-02, the cap was increased to $72.2 million plus an inflation adjustment.[41]

Q. What is DEU proposing regarding this program going forward?

A. As described in the Direct Testimony of Mr. Kelly B. Mendenhall, DEU requests continuation of the Infrastructure Tracker Program at the current budget level, adjusted in future years using the GDP deflator.[42] According to discovery, DEU's 2022 infrastructure budget, adjusted for inflation, is $77.4 million.[43]

Q. What is your response to this proposal?

A. As the Commission noted in its order in Docket No. 19-057-02, continuation of the Infrastructure Tracker Program requires approval in every general rate case.[44]

[39] Docket No. 09-057-16, Report and Order Issued June 3, 2010, p. 21.
[40] Docket No. 13-057-05, Report and Order Issued February 21, 2014, p. 8.
[41] Docket No. 19-057-02, Report and Order Issued February 25, 2020, p. 13.
[42] Direct Testimony of Kelly B. Mendenhall, lines 417-419.
[43] DEU Response to OCS Data Request 8.18, included in UAE Exhibit RR 1.6.
[44] Docket No. 19-057-02, Report and Order Issued February 25, 2020, p. 10, footnote 11.

If the Commission approves the continuation of this program, I recommend that annual expenditures be capped at no more than $77.4 million *without* future adjustments for inflation in order to provide reasonable cost containment for the tracker mechanism. The cap does not preclude DEU from making prudent investments if the investment costs are in excess of the cap – it merely restricts the amount of expenditures that are eligible for tracker recovery. The Commission should deny the request to continue to add automatic increases to the annual expenditure amount that is eligible for single-issue ratemaking treatment, as such mechanisms should be used sparingly, if at all.

Q. Does this conclude your direct Phase I testimony?

A. Yes, it does.