Witness OCS – 2S

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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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**
	)	
	)	**Surrebuttal Testimony**
	)	**John Defever, CPA**
	)	**On Behalf of the**
	)	**Office of Consumer Services**
	)	

October 13, 2022

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<u>Introduction</u>

Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

A. My name is John Defever. I am a Certified Public Accountant, licensed in the State of Michigan. I am a senior regulatory consultant in the firm of Larkin & Associates, PLLC, with offices at 15728 Farmington Road, Livonia, Michigan.

Q. ARE YOU THE SAME JOHN DEFEVER THAT PROVIDED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of this Surrebuttal Testimony is to respond to DEU witness Jordan Stephenson's Rebuttal Testimony.

Q. HAVE YOU CHANGED ANY OF THE RECOMMENDATIONS IN YOUR DIRECT TESTIMONY BASED ON THE COMPANY'S REBUTTAL TESTIMONY?

A. Yes. As discussed below, after reviewing the Company's Rebuttal testimony I have made changes to my adjustments to payroll expense, depreciation, and working capital. The updated adjustments and the related flow throughs are as follows:

Working Capital ($3,907,852)
Payroll ($2,253,214)
Depreciation Expense ($323,754)

Corresponding Flow-Through Adjustments:

Accumulated Depreciation $146,805
Benefits $168,578
Payroll Tax ($144,251)
Income Tax $1,447,007

These changes result in an updated Utah revenue increase of $36,276,841. The changes are discussed below and reflected in the attached Exhibit 2.1S.

<u>Plant in Service - Contingencies</u>

Q. DID THE COMPANY'S REBUTTAL ADDRESS YOUR ADJUSTMENT TO CONTINGENCIES?

A. Yes. The Rebuttal stated that my understanding and characterization of contingencies does not properly reflect the Company's use of contingencies in its budgeting practices.[1]

Q. IS YOUR CHARACTERIZATION OF CONTINGENCIES DIFFERENT FROM THE COMPANY'S DESCRIPTION OF CONTINGENCIES?

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[1] Stephenson Rebuttal p.3.

A. It does not appear to be. My testimony describes contingencies, as costs that the Company does not know will occur. The Rebuttal cites the following about contingencies:

> An amount added to an estimate to allow for items, conditions, or events for which the state, ***occurrence, or effect is uncertain*** that experience shows will likely result, in aggregate, in additional costs.[2] (emphasis added)

The Company's Rebuttal states that the occurrence is uncertain, which is consistent with my testimony that states it is not known whether the costs will occur. The second part of the above quote says that the costs will ***likely*** result in additional costs. Again, my testimony does not state the costs are ***unlikely*** to occur, it states that it is not ***known*** that the costs will occur.

Q. THE REBUTTAL STATES "THIS NOT SIMPLY A 'BUDGET BUFFER' ADDED TO EXPECTED PROJECT COSTS…" DID YOUR TESTIMONY STATE THAT CONTINGENCIES ARE SIMPLY A BUDGET BUFFER?

A. No. My testimony did not state that the Company uses contingencies as a buffer. My testimony stated that the use of contingencies can become a budget buffer. Regardless of the Company's intention when budgeting, a contingency increases the total cost, and that total cost can become the

[2] Stephenson Rebuttal p. 3 citing Frederic C. Jelen, James H. Black.

target amount whether or not the contingency occurs. As a result, a contingency can evolve into a budget buffer.

Q. PLEASE DISCUSS THE CHART ON PAGE 132 OF MR. STEPHENSON'S REBUTTAL TESTIMONY.

A. The chart provides budget-to-actual capital expenditures over the prior five years. The chart shows that the total spend has been within .6% of budget including contingencies.[3] The Rebuttal claims that this historical evidence supports the Company's budgeting accuracy.

Q. DOES THIS CHART SUPPORT THE ACCURACY OF CONTINGENCIES IN THE BUDGETING PROCESS?

A. No. The chart as provided does not include the necessary information to reach such a conclusion. The chart is very high-level, providing only the budgeted expenditures, actual expenditures and the difference between them. The amount of information that it does not provide is significant. It does not provide a list of the projects budgeted and a list of the projects completed with costs for each. The actual spend may have included projects that were not budgeted or some projects may have been overbudget while other projects may have been underbudget.

[3] Stephenson Rebuttal p.5.

Most importantly, the chart does not even provide a list of the contingencies that were budgeted and which contingencies were necessary. As such, it cannot speak to the accuracy of the budgeted contingencies. In fact, without providing any such details, the chart could actually be a demonstration of the budget buffer effect described above (i.e., where the budget that is inflated for contingencies becomes the target budget whether or not the contingencies occur.)

This chart only shows that spending was close to budget. Without providing any of the relevant details, no other conclusions should be drawn from it.

Q. HAVE YOU RECONSIDERED YOUR RECOMMENDATION TO REMOVE CONTINGENCIES AFTER REVIEWING THE REBUTTAL TESTIMONY?

A. No. Ultimately, if the cost and necessity of the contingency were known at the time of budgeting it would not be considered a contingency. As the costs are not known and measurable, they should not be included. As stated in my testimony, if the additional funds become necessary, the Company can request recovery in the next GRC.[4]

Q. THE REBUTTAL STATES THAT 2.03% IS A MORE APPROPRIATE RATE FOR CALCULATING DEPRECIATION THAN 3.88% AS USED IN YOUR SCHEDULES.[5] DO YOU AGREE?

A. Yes. After reviewing Mr. Stephenson's Rebuttal, I agree that 2.03% is a more appropriate rate and have reflected that rate in my adjustments. The resultant changes to my adjustments are stated at the beginning of this testimony.

<u>Incentive Compensation in Rate Base</u>

Q. DID THE COMPANY'S REBUTTAL IMPACT YOUR OPINION REGARDING THE REMOVAL OF INCENTIVE COMPENSATION IN RATE BASE?

A. No. My testimony stated that capitalized incentive compensation based on financial goals should be removed because it does not benefit ratepayers. Given the opportunity to rebut this statement by

[4] Defever Direct p. 8.

[5] Stephenson Rebuttal p. 6.

demonstrating that ratepayers benefit from this expense, the Company did not do so. Instead, the Company's Rebuttal argued that if the capitalized incentive compensation is removed from rate base, the pension credit should be removed as well.[6] However, my direct testimony on this issue made no mention of pension credits. This attempt to conflate these unrelated adjustments is not only incorrect, but distracts from the appropriate adjustment for incentive compensation.

In addition, much of the Rebuttal discusses the difference between the treatment of O&M costs and capitalized costs, an issue that also was not discussed in my testimony. To be clear, my recommended adjustment is not based on or connected to the Company's treatment of pension credits. The bottom line is that ratepayers do not benefit from financial-based incentive compensation and therefore it should be removed from rate base.

Q. DOES THE COMPANY'S REBUTTAL MISCHARACTERIZE YOUR TESTIMONY?

[6] Stephenson Rebuttal pages. 7-9.

A. Yes. The Rebuttal states that my testimony argues that the O&M adjustment for incentive cost should be applied to the capitalized portion of incentive costs. This is incorrect. My position is that the incentive compensation goals related to financial goals should be removed from rate base because customers do not benefit, not because a similar adjustment was made to O&M. Although my testimony did refer to the O&M adjustment, the purpose was to cite the reasons for the adjustment (i.e., no customer benefit) not to suggest that the O&M adjustment should be applied to capitalized incentive compensation.

<u>Cash Working Capital</u>

Q. PLEASE SUMMARIZE DEU'S REBUTTAL POSITION ON CASH WORKING CAPITAL

A. The Rebuttal states that the use of 2019-2021 data to calculate lead-lag days is appropriate because the 2021 data is more recent and will more closely reflect 2023 conditions.[7] The Company believes that the ripple effects will carry into 2022 and likely 2023 as well.[8] The Rebuttal also

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[7] Stephenson Rebuttal, p.9.

[8] Id.

states that my adjustment implicitly assumes that 2023 delivery times will revert to 2019 delivery times.[9]

Q. IS IT YOUR ASSUMPTION THAT 2023 DELIVERY TIMES WILL REVERT TO 2019 DELIVERY TIMES?

A. No. However, it is my best estimate that 2019 delivery times are a better indicator than the two initial pandemic years. While both the Company and I acknowledge the need to consider the impact of the pandemic when estimating delivery times, we reach different conclusions on how to do so. Regarding this issue, the Company stated the following:

> …due to potential COVID-19 impacts to 2020 collections that would not be indicative of normal operating conditions, the current study uses a 3-year average for the collection lag based on 2019-2021 totals.[10]

I agree with the Company that 2020 collections would not be indicative for the rate year. As such, my adjustment to use 2019 data did not assume that 2023 delivery times would be the same as 2019 but instead that 2023 delivery times would be closer to 2019 than the worst year of the pandemic.

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[9] Id.

[10] OCS 2.66.

It appears the Company is also implicitly assuming that the impact will decline over time. The Rebuttal describes the impact as “ripple” effects that “carry into 2022 and will likely carry into 2023.” As such, it should also be noted that rates will be set not just for 2023 but also the subsequent years until the next rate case. Therefore, it is still my opinion that 2019 will be a better indicator than the first two years of the pandemic.

Q. DO YOU AGREE THAT THERE IS AN ERROR IN YOUR WORKING CAPITAL SCHEDULE?

A. Yes. I have reviewed Mr. Stephenson’s Rebuttal testimony regarding an error in the calculation of the lag day factor in my schedules.[11] Accordingly, I have corrected this error. My updated recommended working capital adjustment is a reduction of $3,907,852 as stated on page 2 of this testimony.

<u>Gain on Sale of Utility Property</u>

Q. THE DEU REBUTTAL AGREES TO A REDUCTION TO THE REVENUE REQUIREMENT OF $1,554,138 ($518,046 OVER THREE YEARS) TO

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[11] Stephenson Rebuttal p. 10.

REFLECT GAIN ON SALE OF PROPERTY.[12] HOW WAS THIS AMOUNT DETERMINED?

A. Both UAE witness Mr. Higgins and I made adjustments to reflect the gain on sale of property. My adjustment returned all of the gains to ratepayers, while Mr. Higgins' adjustment shared the gains between the Company and the ratepayers. The Company's Rebuttal accepted Mr. Higgins approach.

Q. WHAT DOES THE REBUTTAL STATE ABOUT THE SHARING OF THE GAIN?

The Rebuttal states that "[a]llowing the Company to maintain a portion of gain on property sales will help incentivize careful consideration of opportunities to realize value in utility property as circumstances may allow." However, it is my opinion that the Company should not require extra incentives to responsibly manage utility property.

Q. DO YOU AGREE WITH THIS ADJUSTMENT?

A. I consider it an improvement over the treatment in the Company's original filing in which ratepayers received none of this gain. However, it is still my position that the full gain of $2,332,765 should be reflected. As ratepayers

[12] Stephenson Rebuttal p. 11.

have paid a return of and on this property, they should receive all of the gain.

<u>Directors and Officers Liability Insurance</u>

Q. WHAT DOES THE DEU REBUTTAL STATE ABOUT D&O INSURANCE?

A. The Rebuttal argues that D&O Insurance is an industry standard, necessary to attract and retain qualified candidates and should therefore be included in the revenue requirement.[13]

Q. IS THIS A COMPELLING ARGUMENT?

A. No. Even if D&O is considered a standard business cost, it does not necessarily follow that it should be recoverable from ratepayers. Not all industry standard costs are fully recoverable. Costs related to image-building advertising and lobbying costs, for example, are typically excluded from recovery from ratepayers.

Q. IS YOUR RECOMMENDED ADJUSTMENT BASED ON WHETHER OR NOT D&O IS ACCEPTED AS AN INDUSTRY STANDARD?

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[13] Stephenson Rebuttal p.12.

A. No. The issue is not whether the cost is standard but who receives the benefits of the cost. As the Company and its shareholders receive most of the benefits, my recommendation to share costs 75/25 between the shareholders and the ratepayers, respectively, is appropriate.

Insurance Expense

Q. PLEASE SUMMARIZE THE COMPANY'S REBUTTAL CLAIMS REGARDING INSURANCE EXPENSE.

A. The Rebuttal states that my use of a 5-year average to determine insurance costs is inappropriate because those costs have been volatile over the previous five years as a result of reorganization, accounting system changes, and process migration following the 2016 merger with Dominion Energy.[14] The Rebuttal further states that processes have now stabilized resulting in the most recent years being more appropriate starting points for projecting insurance costs.[15]

Q. DO YOU AGREE WITH THE COMPANY'S REBUTTAL ON THIS ISSUE?

A. No. The Rebuttal's attempt to declare the prior years inappropriate for use are undetailed and unsupported. For example, the Rebuttal attempts to

[14] Stephenson Rebuttal p. 12.

[15] Id.

cast doubt on the relevance of the prior years' expenses by stating "[f]or periods during this transition, the Company received no allocated expenses from Dominion Energy Services (DES)."[16] However, the Rebuttal does not state which periods received no allocated expenses. Without that information, it cannot be determined which years were impacted or if the impact was relevant in determining this cost.

Q. ARE THE MOST RECENT YEARS STABLE FOR THESE INSURANCE COSTS?

A. The Rebuttal states the following:

> Over time as systems were transitioned across functions and department, the processes have stabilized. As a result, insurance costs in more recent years are a more appropriate starting point for insurance costs.[17]

For Other Insurance, DEU's claims that the most recent years are more stable and therefore more appropriate are belied by the 2020 and 2021 information. As seen in the chart below, the expense dropped $23,616 from 2020 to 2021.[18]

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[16] Id.

[17] Stephenson Rebuttal page 12.

[18] OCS 2.31.

Other Insurance				
2017	2018	2019	2020	2021
$116,929	$35,527	$76,597	$143,411	$119,795

In addition, the Rebuttal states:

> "Other Insurance" is made up primarily of broker fees, which are expected to remain steady from year to year going forward.[19]

The Company provides no reason or support for its expectations that this cost will remain steady going forward. The only evidence the Company has provided is the historical record, which instead of indicating steadiness suggests a likelihood of fluctuations.

Regarding Workers Compensation, the Rebuttal states that the expense has been stable for the past two years "making 2021 a reasonable starting point to estimate 2023…"[20] However, a similar amount for two years is not an indication that this expense will continue at that amount. Workers Compensation is generally based on claims and can fluctuate from year to year based on the levels of claims. For costs that fluctuate, a 5-year average is often recommended.

[19] Id. p. 12-13.

[20] Stephenson Rebuttal p. 12.

Q. SHOULD YOUR INSURANCE ADJUSTMENTS BE MODIFIED BASED ON THE COMPANY'S TESTIMONY?

A. No. The Company has attempted to undermine the value of the historical information but has not provided a more appropriate method to project these expenses. As such, my recommendation based on the historic record is still the most appropriate.

<u>Economic Development</u>

Q. DID THE COMPANY'S REBUTTAL DISCUSS ECONOMIC DEVELOPMENT?

A. Yes. The Company is asking ratepayers to fund the attempt to bring new investments to the state and new customers to the utility. The Rebuttal states the following:

> The economic development activity consists largely of contributions made to the Economic Development Company of Utah (EDCU).
>
> …
>
> The EDCU plays a pivotal role in attracting investment in the state and bringing corporations and jobs to sites across the Company's service territory.
>
> …
>
> In return, the Company benefits by receiving useful and timely information about where new development is planned to take place. This information provides the Company with useful insight into the

> growing communities it serves and informs it system planning and analysis. In addition, as new entities are attracted to invest in Utah, their natural gas usage helps contribute to fixed utility costs, which benefits customers by reducing rates for existing customers on the distribution system.[21]

Q. IS THIS A COMPELLING ARGUMENT?

A. No. It is not the responsibility of the ratepayers to attract new investments to the state or bring new customers to the utility. The results described may provide benefits for the Company but may provide little or no benefit to ratepayers. Investing in economic development is not necessary for the provision of utility service and should not be recoverable from ratepayers. If the Company wants to engage in such activities, it should do so at its own expense.

<u>Labor</u>

Q. THE COMPANY'S REBUTTAL STATES THAT YOUR ADJUSTMENT ASSUMES THAT THE 2023 HEADCOUNT WILL EQUAL THE LEVEL IN MAY 2022.[22] IS THAT CORRECT?

A. No, there is no such assumption in my testimony. The basis for my adjustment is not an assumption of zero growth but the ratemaking

[21] Stephenson Rebuttal p. 13.

[22] Stephenson Rebuttal p.15.

principle that the Company must support the costs for which it requests recovery. As the Company has averaged over 20 vacancies per year over the prior 5 years, DEU employee level accuracy cannot be assumed. I chose the current level (as of May, 2022) as the most known and measurable employee level at the time my testimony was prepared.

Q. HAS THE COMPANY HIRED MORE EMPLOYEES SINCE MAY 2022?

A. Yes, the headcount as of August was 897.[23] However, hiring employees is not the same as retaining employees. While the Company may hire 20 employees one month, they may lose 10 to attrition another month. It cannot be assumed that every new hire represents one additional employee to the average headcount. For example, the chart below shows the monthly level of full-time employees for 2020.[24]

2020 Full-Time Employees											
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
830	826	836	838	839	842	839	835	836	831	830	831

[23] Id.

[24] OCS 2.43 Attachment 1.

The headcount started at 830 in January, increased to a high of 842 in June, and finished the year with only one more employee in December than it started with.

Q. THE REBUTTAL STATES THAT IN 2018 AND 2019, THE COMPANY HEADCOUNT AVERAGED .55 MORE FULL TIME EMPLOYEES THAN BUDGET. DOES THIS SUPPORT THE LIKELINESS THAT THE COMPANY WILL HIRE AND RETAIN THE BUDGETED AMOUNT FOR THE RATE YEAR?

A. Not at all. My direct testimony shows that the Company averaged over 20 vacancies per year from 2017-2021.[25] The Rebuttal claims that 3 of those years were non-representative, that 2018 and 2019 were the most representative, and that the headcount of those two years averaged .55 over budget. However, this statement is misleading because in each of the years 2018 and 2019, the budgeted headcount was lower than the actual headcount for the previous year. The Company had 897 employees as of December 2017 but budgeted only 882 for January 2018. At the end of 2018 the Company had 916 full time employees and budgeted 911 for January 2019. The Company's two-year history of budgeting less

[25] Defever Direct p.25.

employees than it currently had should not be mistaken for support for the Company's likeliness to hire and retain new employees.

Q. HAVE YOU REVISED YOUR ADJUSTMENT BASED ON THE COMPANY'S REBUTTAL TESTIMONY?

A. Yes. In my direct testimony I used the current level of employees (May 2022) as basis for my adjustment because it was the most known and measurable amount. However, as of September 1, 2022, the employee total has increased to 897.[26] I have updated my recommendation to disallow costs related to unhired employees using the new headcount as the most known and measurable employee level. This adjustment can be considered favorable to the Company because it accepts the current level of employees without consideration of any attrition that may occur during the year. The result is a reduction to payroll expense of $2,322,902 ($2,253,214 Utah) as shown on page 2 of this testimony.

Q. DO YOU PROPOSE AN ALTERNATE ADJUSTMENT?

A. Yes. If the Commission declines to accept my recommended adjustment to hold the employee count to the current amount, an alternative adjustment based on average vacancies could be made. Because the

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[26] DEU Exhibit 3.39R.

Company has averaged over 20 vacancies during the prior 5 years, the reduction of 20 employees from the Company's request is justified. This would result in a reduction of $1,720,668 ($1,669,048 Utah) to payroll expense as shown on page 2 of this testimony.

SERP

Q. THE DEU REBUTTAL STATES THAT THE SERP BENEFITS ARE BASED ON WHAT IS NECESSARY TO ATTRACT AND RETAIN EMPLOYEES.[27] DO YOU AGREE?

A. No. The Company has not supported the claim that this additional retirement benefit is necessary to attract and retain employees. These costs should not be recoverable until they are shown to benefit ratepayers.

Fitness Center

Q. THE COMPANY'S REBUTTAL CLAIMS THAT THE FITNESS CENTER SERVES AN IMPORTANT ROLE IN THE ATTRACTION AND RETENTION OF HIGH-QUALITY EMPLOYEES.[28] IS ANY SUPPORT PROVIDED?

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[27] Stephenson Rebuttal p. 19.

[28] Stephenson Rebuttal p.19

A. No support was provided for that statement. Ratepayers should not be responsible for costs that are unnecessary for the provision of utility service and provide no clear benefit. Also, as stated in my direct testimony, only $1,024 of the $16,605 total fitness is for the Utah fitness center; the rest of the cost is allocated for the fitness center at the Corporate headquarters in Virginia.[29]

Caregiver Program

Q. IN ITS REBUTTAL, DEU MAKES THE CLAIM THAT THE CAREGIVER PROGRAM SERVES AN IMPORTANT ROLE IN THE ATTRACTION AND RETENTION OF HIGH-QUALITY EMPLOYEES.[30] HOW DO YOU RESPOND?

A. DEU makes that assertion without providing any support. As the Company has not provided any link between this program and customer benefits, the costs should be disallowed.

[29] Defever Direct p. 34.

[30] Stephenson Rebuttal p.19

Employee Cafeteria

Q. DEU STATES THAT THE EMPLOYEE CAFETERIA SERVES AN IMPORTANT ROLE IN THE ATTRACTION AND RETENTION OF HIGH-QUALITY EMPLOYEES.[31] DO YOU AGREE?

A. DEU has not provided any support for the notion that providing subsidized meals for employees has any impact on employee hiring or retention. Nor has the Company demonstrated that subsidized meals are the norm in the workplace. Ratepayers should not pay for utility employee meals based on this vague assertion.

Conclusion

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes.

[31] Stephenson Rebuttal p.19