BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

Phase I Surrebuttal Testimony of Kevin C. Higgins

on behalf of

UAE

Docket No. 22-057-03

October 13, 2022

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SURREBUTTAL 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. Are you the same Kevin C. Higgins who prefiled Phase I direct and rebuttal testimony and Phase II direct testimony on behalf of the Utah Association of Energy Users Intervention Group ("UAE") in this proceeding?

A. Yes, I am.

II. OVERVIEW AND CONCLUSIONS

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

A. My testimony responds to the Phase I rebuttal testimony of Dominion Energy Utah ("DEU") witnesses Mr. Jordan K. Stephenson on the topics of pension expense, labor expense related to employee count, and incentive compensation included in rate base; and Mr. Kelly B. Mendenhall on the topic of the Infrastructure Tracker.

Q. Please summarize your conclusions and recommendations.

A. My testimony offers the following recommendations:

1) I continue to recommend that DEU's negative pension expense be included in the revenue requirement rather than setting pension expense to zero for ratemaking purposes. I revised my pension expense adjustment in my Phase II rebuttal testimony to reflect DEU's purported capitalization treatment, which reduced the amount of my recommended adjustment.

2) My adjustment for employee count should be adopted by the Commission. I do not believe it is reasonable for DEU to use a future test year to escalate the labor-related revenue requirement to levels that are 13.8% greater than what was demonstrably required in the base period.

3) I continue to recommend that the Commission exclude financially-related compensation from rate base. DEU appropriately removed the *expense* portion of the financially-related compensation from the revenue requirement, but included the capitalized portion in rate base. If a cost is not properly recoverable from customers, then it makes no difference whether it is an expense or capitalized cost: it should be removed from the revenue requirement.

4) I continue to recommend that the Commission cap annual expenditures under the Infrastructure Tracker at $77.4 million without an inflation adjustment and disagree with DEU's contention that adoption of this recommendation would

increase costs to ratepayers. The Infrastructure Tracker is a single-issue ratemaking mechanism that allows DEU to avoid regulatory lag; as such, it is reasonable to cap the annual amount that is eligible for inclusion in this program without a presumption that the Company is also entitled to an additional inflation adjustment.

III. RESPONSES TO DEU ON REVENUE REQUIREMENT ISSUES

Pension Expense

Q. In your Phase I direct testimony, you recommended an adjustment to recognize DEU's pension expense in the revenue requirement based on DEU's projected 2023 net periodic benefit cost. Have you since revised the amount of your recommended adjustment?

A. Yes, as I explained in my Phase I rebuttal testimony, I revised my adjustment to reflect DEU's purported pension cost capitalization treatment, which reduced the amount of my adjustment. While DEU's explanation of its pension cost capitalization policies is not entirely convincing, my intention is to reflect the proper amount of pension expense in the revenue requirement. Based on DEU's explanation that its 2023 capital budget includes ($11,076,744) in capitalized pension cost,[1] I have limited my pension adjustment to the remaining ($10,044,611) expense portion. I note that in his rebuttal testimony, Office of Consumer Services witness John Defever has incorporated this same adjustment.[2]

[1] Rebuttal Testimony of Jordan K. Stephenson, p. 8.
[2] Rebuttal Testimony of John Lefever at lines 18-86.

I also continue to recommend that the prepaid pension asset (and its associated accumulated deferred income tax [“ADIT”]) not be included in rate base.

Q. In his rebuttal testimony, DEU witness Mr. Jordan K. Stephenson claims your recommended approach is asymmetrical.[3] How do you respond to this claim?

A. I disagree. I believe it is asymmetrical to set the revenue requirement for pension expense at zero when pension cost under Generally Accepted Accounting Principles (“GAAP”) is negative, despite the historical inclusion of positive pension expense in rates and without committing to permanently exclude any positive pension expense in the future.

By definition, over the life of a pension plan, the cumulative sum of the annual GAAP pension costs (including negative pension costs) will equal the cumulative sum of the Company’s funding contributions. This means that setting customer pension cost responsibility in rates equal to GAAP pension cost ensures that, by and large,[4] customer rates will fully fund the pension plan costs over the life of the plan. Selectively “zeroing out” pension expense in rates when GAAP pension cost is negative will cause customers to overpay for pension cost over the life of the pension plan – unless in the future, when pension cost is again positive, adjustments are made to reduce the revenue requirement associated with the positive pension cost. DEU indicates no willingness to do that.

[3] Rebuttal Testimony of Jordan K. Stephenson at lines 618-621.

[4] Since GAAP 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.

As I stated in my direct testimony, I recognize that the Commission may be reluctant to recognize a negative pension expense in the revenue requirement, as it is a non-cash item. But at the same time, it is important to recognize that the alignment between GAAP pension costs and company contributions to a pension plan is a long-term proposition. Utilities are in a unique situation in that a third-party, i.e., ratepayers, are enlisted to pay for utilities' GAAP pension costs. Given this arrangement, it is not unreasonable for the third-party to receive the benefit of negative pension costs when they occur, if for no other reason than to ensure the *long-term alignment* between the pension costs recovered from customers in rates and the contributions from the utility over the life of the pension plan. If recognizing the benefit of negative pension costs in rates is not acceptable, then it would be appropriate to reconsider whether customers should bear any going-forward responsibility to pay for any future positive pension costs.

Q. Mr. Stephenson is critical of your comparison of pension cost recovery to recovery of depreciation expense.[5] Do you wish to respond?

A. Mr. Stephenson over-interprets my analogy, taking it much further than I intended. My point was simply that there are certain *ratemaking conventions* that are devised with *long-term* cost recovery in mind, rather than the annual cash costs to the utility. Over the life of a pension plan, recovery of the GAAP costs from customers ensures that customers fully pay for the contributions made by the utility to the plan, irrespective of whether the GAAP costs match the cash

[5] Rebuttal Testimony of Jordan K. Stephenson at lines 723-744.

contributions by the utility in a given test year. Similarly, over the life of an asset, recovery of depreciation expense ensures that customers provide a return of the investment costs made by the utility. Both ratemaking treatments ensure long-term alignment between the outlays made by the utility for long-lived assets and cost recovery from customers. That was the extent of my comparison.

Q. Mr. Stephenson claims that you recommend including both the negative pension expense *and pension-related ADIT* in the revenue requirement while excluding the prepaid pension asset.[6] Is this a correct characterization of your testimony?

A. No. I recommend against including the prepaid pension asset *or its associated ADIT* in rate base. My revenue requirement calculation did not alter the portion of DEU's pension adjustment related to the prepaid pension asset and associated ADIT. Therefore, my revenue requirement calculation does not include the ADIT associated with the prepaid pension asset as reduction to rate base.

Labor Expense – Employee Count

Q. How has DEU responded to your recommended adjustment regarding employee count?

A. DEU does not accept my adjustment, but instead proposes that customers pay 13.8% more in labor cost in rates than the Company actually experienced in the base period, 2021.[7] In my opinion, this increase is excessive. The savings from

[6] Rebuttal Testimony of Jordan K. Stephenson at lines 607-625.
[7] Rebuttal Testimony of Jordan K. Stephenson at lines 442-445.

the lower labor costs in the 2021 base period flowed to shareholders, and my adjustment, which is based on the Company's average full-time equivalent ("FTE") levels for the year ending June 2022, trims only 3.7% off the requested 13.8% increase. I do not believe it is reasonable for DEU to use a future test year to escalate the labor-related revenue requirement to levels that are nearly 14% greater than what was demonstrably required in the base period.

I note that I proposed a similar adjustment with nearly identical timing parameters in Rocky Mountain Power's most recent general rate case – an adjustment that Rocky Mountain Power accepted and which was approved by the Commission.[8] In that case, Rocky Mountain Power used a base period ending December 2019 and a projected test period ending December 2021. My adjustment for employee count in that case used the average FTE levels for the year ending May 2020 – only one month earlier in relative terms to the adjustment I am proposing in this case. My adjustment was reasonable in that case, as recognized by Rocky Mountain Power and the Commission, and it is equally reasonable in this case.

Q. In his rebuttal testimony, Mr. Stephenson states that you did not incorporate any forward-looking growth in Company headcount.[9] How do you respond?

A. I believe Mr. Stephenson's characterization of my adjustment is incomplete. While I did not assume *further* growth in the Company's headcount beyond June

[8] Docket No. 20-035-04, Rebuttal Testimony of Steven R. McDougal at lines 311-318.
[9] Rebuttal Testimony of Jordan K. Stephenson at lines 385-391.

2022, my adjustment already included FTE growth relative to the 2021 base period of 17 FTE.[10]

Q. Do you have any other comments regarding DEU's response to your employee count adjustment?

A. Yes. As part of my investigation into DEU's employee count, I noticed certain inconsistencies in DEU's exhibits and inquired about them through discovery.[11] DEU's response indicated that the Company committed an error in its filing. Correcting the error would cause an increase in labor-related revenue requirement labor costs of $1,004,579.

In the interest of fairness, I included this labor cost correction in my recommended revenue requirement, which reduced the net effect of my employee count adjustment to $637,655 ($1,642,234 - $1,004,579). In its rebuttal filing, DEU cherrypicked my recognition of its labor cost error by accepting that adjustment on a standalone basis, while rejecting my FTE count adjustment.[12] Although my employee count adjustment stands on its own merit, if the Commission is inclined to accept the $1.0 million error correction that favors DEU, I believe it would be all the more reasonable to accept my employee count adjustment in tandem with it.

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[10] *See* UAE RR Exhibit 1.1, page 2.
[11] *See* DEU Response to UAE Data Request 4.02, included in UAE RR Exhibit 1.6, attached to my Phase I Direct Testimony.
[12] Rebuttal Testimony of Jordan K. Stephenson at lines 353-476.

Financially-Related Incentive Compensation

Q. In his rebuttal testimony, Mr. Stephenson objects to your adjustment to remove the capitalized portion of financially-related incentive compensation.[13] What is your response?

A. DEU appropriately removed the *expense* portion of the financially-related compensation from the revenue requirement, but included the capitalized portion in rate base. If a cost is not properly recoverable from customers, then it makes no difference whether it is an expense or capitalized cost: it should be removed from the revenue requirement. My adjustment only extends to the amounts capitalized since the last general rate case.

In defending DEU's inconsistent treatment of this item, Mr. Stephenson expands the discussion to include the negative pension cost, asserting that the Company included negative pension cost as a reduction to rate base and claiming that if the capitalized portion of the financially-related incentive compensation is removed from rate base, then the negative capitalized pension cost should be removed from rate base as well. As I discussed above, I reduced my adjustment to pension expense in my Phase I rebuttal testimony to reflect DEU's assertions regarding its capitalization of negative pension cost. My position on this issue is consistent: if negative pension cost is capitalized it should be reflected in rate base (as DEU apparently has done) and the non-capitalized pension cost should be reflected as a reduction to O&M expense (which DEU has not done).

[13] Rebuttal Testimony of Jordan K. Stephenson at lines 158-218.

Infrastructure Tracker

Q. Mr. Mendenhall contends that adoption of your proposal to cap the annual expenditures under Infrastructure Tracker at $77.4 million without an inflation adjustment would increase costs to ratepayers.[14] Do you agree?

A. No. The basis of Mr. Mendenhall's contention is that for each year that replacements are "deferred for lack of adequate budget," inflation will increase the ultimate cost of those projects for customers. But as Mr. Mendenhall admits, DEU capital expenditures are not limited by their eligibility for the Infrastructure Tracker program. DEU has a responsibility to provide safe and reliable service, irrespective of whether a tracker mechanism exists at all. The Infrastructure Tracker is a single-issue ratemaking mechanism that allows DEU to avoid regulatory lag; as such, it is reasonable to cap the annual amount that is eligible for inclusion in this program without a presumption that the Company is also entitled to an inflation adjustment on top of that amount.

Q. Does this conclude your Phase I surrebuttal testimony?

A. Yes, it does.

[14] Rebuttal testimony of Kelly B. Mendenhall at lines 317-321.