

ORIGINAL	
N.H.P.U.C. Case No.	<u>DG 11-069</u>
Exhibit No.	<u># 7</u>
Witness	<u>G. Gantz + S Frink</u>
DO NOT REMOVE FROM FILE	

STATE OF NEW HAMPSHIRE

BEFORE THE
PUBLIC UTILITIES COMMISSION

DG 11-069

Northern Utilities, Inc.

DIRECT TESTIMONY

OF

JAMES J. CUNNINGHAM JR.

Date: March 26, 2012

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

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

5 **Q. Please summarize your educational and professional background.**

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

15 **Q. What is the purpose of your testimony?**

16 A. My testimony provides a summary of the settlement agreement pertaining to 1)
17 depreciation expenses, 2) amortization of intangible assets, 3) pension and post-
18 employment benefits other than pensions (PBOPs), 4) medical and dental expenses, 5)
19 401K expenses, and 6) depreciation-related rate base adjustments.

20 **Q. Please summarize the settlement agreement pertaining to depreciation expenses.**

21 A. Overall, the settlement agreement provides \$3,884,633 for depreciation expense, a
22 reduction of \$374,366 from the proposed amount. There are two components comprising
23 this reduction: a depreciation accrual rates component and a reserve variance component.
24 The depreciation accrual rate component provides a reduction of \$205,873 from the
25 amount proposed by Northern Utilities, Inc. ("Company"). The amortization component
26 provides a reduction of \$168,493 from the amount proposed.

1 **Q. Please describe the methodology used to calculate depreciation expense.**

2 A. The settlement agreement reflects the new depreciation study prepared by the Company's
3 consultant, Mr. Paul Normand. This study utilized the whole-life technique, a technique
4 that has been used by the Commission for many years and is defined by the following
5 formula:

$$\frac{1-(\text{Net Salvage Percentage})}{\text{Average Service Life}}$$

6
7
8
9 After the depreciation accrual rates are determined, they are then multiplied by the plant
10 balances as of December 31, 2010 to determine depreciation expense.

11 For settlement purposes, certain modifications were made to the proposed depreciation
12 accrual rates. Specifically, certain agreed upon changes were made to net salvage
13 percentages and average service life. The impact of these changes is summarized in
14 Appendix A.

15 **Q. You mentioned that the settlement agreement contains another adjustment for prior
16 year depreciation reserve variances. Please explain this adjustment.**

17 A. The adjustment for prior year depreciation reserve variances is made to reflect the
18 variance between 1) the depreciation reserves that were booked for these prior years and
19 2) what should have been booked had the new settlement agreement depreciation accrual
20 rates been used. The total amount of the calculated reserve variance is a *surplus* of
21 \$3,193,409 (i.e. surplus means that depreciation reserves were too high in prior years).
22 The settlement agreement amortizes this surplus over an agreed-upon 12-year term.

23 **Q. Please summarize the settlement agreement pertaining to the amortization of
24 intangible assets.**

25 A. The settlement agreement provides \$369,009 for amortization of intangible assets, a
26 reduction of \$35,603 from the amount proposed. It was agreed, for settlement purposes,

1 that this amount includes amortization for intangible assets added during the 2011 rate
2 year.¹

3 **Q. Please summarize the settlement agreement pertaining to pensions and post**
4 **employment benefits other than pensions (PBOPs).**

5 A. The settlement agreement provides for \$469,394 for pension expense and \$597,389 for
6 PBOPs for 2011. The pension amount is \$323 below the amount proposed by the
7 Company; and the PBOPs amount is \$7,926 below the amount proposed.

8 Over and above these amounts, expected increases for 2012 amounting to \$113,806, are
9 incorporated in the 2011 revenue requirement, for purposes of settlement. The pension
10 portion of the increase is \$56,742 and the PBOP portion is \$57,064. These amounts are
11 the estimated impacts attributable to a significant decrease in the discount rate, as
12 compared to the discount rate at the time of the filing. When the discount rate declines,
13 pension and PBOP expenses increase, all else being equal. Support for these increases is
14 based on actuarial schedules/estimates provided by the Company in technical sessions in
15 January 2012.

16 **Q. Please summarize the settlement agreement pertaining to medical and dental**
17 **expenses.**

18 A. The settlement agreement provides for \$543,850 for medical and dental expenses for
19 2011, a reduction of \$9,873 from the proposed amount. The settlement agreement
20 reflects a year-end true-up for medical and dental expenses that represents the actual
21 expenses paid by the Company in 2011.

22 **Q. Please summarize the settlement agreement pertaining to 401K expenses.**

23 A. The settlement agreement provides for \$116,561 for 401K expenses, an increase of \$224
24 from the amount proposed by the Company. The settlement agreement reflects updated

¹ Amortization pertains to computer software associated with the CIS 2010 Project, Call Center, GIS Updates and other software as described in the filing at Schedule RevReq-3-15.

1 capitalization rates for the Northern Utilities-New Hampshire Division and the Unitil
2 Service Corporation (USC).

3 **Q. Please summarize the settlement agreement pertaining to the depreciation-related**
4 **rate base adjustment.**

5 A. The settlement agreement provides for an increase to rate base in the amount of
6 \$247,580. This adjustment aligns changes in depreciation with changes in rate base. The
7 adjustment has two components: 1) a depreciation expense component and 2) a deferred
8 income tax component. In the settlement agreement, the depreciation expense
9 component has the effect of increasing the rate base by \$409,969.² The deferred tax
10 component has the effect of decreasing rate base by \$162,389.³ Thus, the net increase to
11 rate base is \$247,580 (i.e. \$409,969 less \$162,389).

12 **Q. Do you recommend that the Commission approve the settlement agreement?**

13 A. Yes.

14 **Q. Please explain why you believe the settlement agreement provides reasonable**
15 **amounts for depreciation expense.**

16 A. The methodology used by the Company is the whole-life technique, a long-established
17 methodology used by the Commission to set depreciation accrual rates. Further, the
18 calculation of depreciation accrual rates utilizes preferred company-specific data, rather
19 than generic industry-wide data. Also, for settlement purposes, a known and measurable
20 adjustment is incorporated. Specifically, the settlement reflects depreciation based on
21 plant-in-service at the end of the 2010 test year, rather than the average plant-in-service
22 during the test year. This has the effect of increasing depreciation expense since 2010
23 year-end plant is higher than the average plant. In addition, the settlement agreement

² This amount represents the sum of the depreciation and amortization changes mentioned earlier in this testimony: i.e. depreciation expense reduction of \$374,366 and reduction in amortization of intangible plant of \$35,603; for a total of \$409,969.

³ The deferred tax component is calculated by multiplying the depreciation and amortization amount of \$409,969 by federal and state combined tax rate of 39.61%, or \$162,389.

1 reflects a 12-year term over which the depreciation reserve variance is amortized, as
2 compared to the proposed 15-year term. Finally, the settlement incorporates a rate base
3 adjustment that aligns the adjustment to depreciation expense with an adjustment to rate
4 base.

5 **Q. Please explain why you believe the settlement agreement provides reasonable**
6 **amounts for pensions, PBOPs and medical and dental expenses.**

7 A. The settlement agreement for pensions for the 2011 rate year is based on an actuarial
8 study prepared by the Company's actuary and reviewed by staff. Further, the amount for
9 2011 pension expense is only \$8,647 above the 2010 test year, or less than a 2 percent
10 increase.

11 The settlement agreement for PBOPs for 2011 rate year is based on an actuarial study
12 prepared by the Company's actuary and reviewed by staff. The amount for the 2011 rate
13 year is higher than the 2010 test year; however, the 2011 amount reflects an increase
14 attributable to the expansion of coverage that the Company is providing to its union
15 represented employees in 2011.

16 Also, for purposes of settlement, the 2011 revenue requirement incorporates an
17 adjustment to pensions and PBOPs that reflects the most recent market data relative to
18 discount rates that shows a significant reduction in the discount rate. The impact of the
19 discount rate reduction, including actuarial schedules and estimates, was provided by the
20 Company in January 2012 and reviewed by staff.

21 With respect to medical and dental expense, the settlement amount reflects a detailed
22 review of the medical and dental plans by staff. Also, the settlement reflects a true-up to
23 medical and dental expenses actually incurred in 2011.

24 Finally, the settlement amount for 401K plans represents a reasonable increase of 6.7
25 percent from the 2010 test year.

26 **Q. Do you have any other comments?**

1 A. No.

2 **Q. Does that complete your testimony?**

3 A. Yes, it does, thank you.

4