FILED 12/8/2020
DOCUMENT NO. 13212-2020
FPSC - COMMISSION CLERK



BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

DOCKET NO. 20200051-GU

PETITION FOR RATE INCREASE BY PEOPLES GAS SYSTEM.
_______________________________/

DOCKET NO. 20200166-GU

PETITION FOR APPROVAL OF 2020 DEPRECIATION STUDY BY PEOPLES GAS SYSTEM.
_______________________________/

DOCKET NO. 20200178-GU

PETITION FOR APPROVAL TO TRACK, RECORD AS A REGULATORY ASSET, AND DEFER INCREMENTAL COSTS RESULTING FROM THE COVID-19 PANDEMIC, BY PEOPLES GAS SYSTEM.
_______________________________/

VOLUME 2
PAGES 256 - 476

PROCEEDINGS: HEARING

COMMISSIONERS PARTICIPATING:
CHAIRMAN GARY F. CLARK
COMMISSIONER ART GRAHAM
COMMISSIONER JULIE I. BROWN
COMMISSIONER DONALD J. POLMANN
COMMISSIONER ANDREW GILES FAY

DATE: Thursday, November 19, 2020

TIME: Commenced: 11:00 a.m.
Concluded: 11:27 a.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: DEBRA R. KRICK
Court Reporter

APPEARANCES: (As heretofore noted.)

PREMIER REPORTING
114 W. 5TH AVENUE
TALLAHASSEE, FLORIDA
(850) 894-0828

# I N D E X

## WITNESSES

P R O C E E D I N G S

(Transcript follows in sequence from Volume 1.)

(Whereupon, prefiled direct testimony of Sean P. Hillary was inserted.)

**PEOPLES GAS SYSTEM**
**DOCKET NO. 20200051-GU**
**FILED: 06/08/2020**

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

**PREPARED DIRECT TESTIMONY**

**OF**

**SEAN P. HILLARY**

**POSITION, QUALIFICATION, AND PURPOSE**

**Q.** Please state your name, address, occupation and employer.

**A.** My name is Sean P. Hillary. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed as the Controller of Peoples Gas System ("Peoples" or "the Company"), a division of Tampa Electric Company ("Tampa Electric").

**Q.** Please describe your duties and responsibilities in that position.

**A.** I am responsible for maintaining the financial books and records of the Company and for the determination and implementation of accounting policies and practices for Peoples. I am also responsible for budgeting and forecasting activities within the Company. I am responsible for all external financial reporting aspects for the Company including quarterly surveillance reports filed with the Commission.

**Q.** Please provide a brief outline of your educational background and business experience.

**A.** I graduated from the University of South Florida in 1993 with a Bachelor of Accounting degree and in 1995 with a Master of Accountancy degree. Prior to joining TECO Energy, I worked for Arthur Andersen & Co. and Florida Power Corporation. At Florida Power Corporation, I worked as an internal auditor and financial analyst. In June 2000, I joined TECO Energy and have held various roles with increasing responsibility including the Director, Business Planning for Tampa Electric and Peoples and the Director, Corporate Financial Reporting for TECO Energy. I am a Certified Public Accountant in the State of Florida, and I have served in my current position as Controller of Peoples since May 2018.

**Q.** Have you previously filed testimony before the Florida Public Service Commission ("Commission")?

**A.** Yes. I have previously filed testimony before this Commission in Peoples' Petition for Recovery of Costs Associated with Hurricane Michael in Docket No. 20190109-GU.

**Q.** Did you prepare any exhibits in support of your prepared direct testimony?

**A.** Yes. Exhibit No. (SPH-1) was prepared under my direction and supervision. My Exhibit consists of 7 Documents, entitled:

| | |
|---|---|
| Document No. 1 | List of MFR Schedules Sponsored or Co-Sponsored |
| Document No. 2 | Operations & Maintenance Expense Summary |
| Document No. 3 | Storm Reserve Analysis |
| Document No. 4 | Manufactured Gas Plant Regulatory Asset Amortization |
| Document No. 5 | Summary of Other Non-Trended O&M by FERC Account |
| Document No. 6 | 2020 and 2021 Capital Budget |
| Document No. 7 | 2021 Test Year Reconciliation of Capital Structure to Rate Base |

The information in the MFR schedules listed in my exhibit are based on the business records of the Company maintained in the ordinary course of business and are true and correct to the best of my information and belief.

**Q.** What are the purposes of your prepared direct testimony in this proceeding?

**A.** The purposes of my prepared direct testimony are to present: (i) support for the Company's decision to use a projected

2021 test year for ratemaking purposes; (ii) the determination of the Company's proposed annual revenue requirement; (iii) the proposed ratemaking treatment for the Company's Cast Iron Bare Steel Rider investments; (iv) the budget process used to develop these financial projections for the test year; (v) the determination of test year net operating income; (vi) the drivers of test year operations and maintenance expense; (vii) the determination of rate base for the test year; and (viii) an explanation of how the Company arrived at its proposed capital structure and cost-of-capital for the projected test year.

These and other matters are covered – at least in part – by schedules included in the Minimum Filing Requirements ("MFRs") required by Rule 25-7.039, Florida Administrative Code ("F.A.C."). I am sponsoring much of the financial information provided in the MFR Schedules A, B, C, D, E, G, and I as indicated in Document No. 1 of my exhibit.

**PROJECTED TEST YEAR**

**Q.** What test year does the Company propose to use in this proceeding?

**A.** In accordance with Rule 25-7.140, F.A.C., Test Year Notification, Peoples notified the Commission on February 7, 2020, it has selected the twelve-month period ending December 31, 2021, as the projected test year for Peoples' petition to modify its rates and charges. Calendar year 2021 is appropriate for use as the test year since it is representative of Peoples' projected revenues and projected cost of service, capital structure and rate base required to provide safe, reliable, cost-effective service to its customers during the period when the Company's new rates will be in effect.

**Q.** When is the Company requesting new base rates to be in effect?

**A.** Peoples requests its proposed base rates become effective January 1, 2021.

**Q.** With 2021 being the projected test year, what is the historic base year in this proceeding?

**A.** The historic base year is the 12-months ended December 31, 2019. All data related to this historical base year is historical data taken from the books and records of the Company, which are kept in the regular course of the Company's business in accordance with Generally Accepted Accounting Principles ("GAAP") and provisions of the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts prescribed by the Commission.

**REVENUE REQUIREMENT**

**Q.** What is the base revenue increase requested by Peoples?

**A.** Using the projected test year ending December 31, 2021, the Company seeks a permanent base revenue increase of $61.7 million. Additionally, the Company is seeking to move approximately $23.6 million into base revenue associated with moving its Cast Iron / Bare Steel Rider ("CI/BSR") investments into rate base and resetting the CI/BSR surcharge, as contemplated by Commission Order No. PSC-2012-0476-TRF-GU, issued on September 18, 2012. This increase is necessary to allow Peoples to (i) continue to provide safe and reliable natural gas service at customer service levels the Company's customers expect; (ii) maintain the Company's financial integrity and access to low cost debt while funding the Company's future capital expenditures; and (iii) have the opportunity to earn a fair return on its investment. The revenue increase is based on the Company maintaining its midpoint return on equity of 10.75 percent, with an overall return of 6.63 percent on its 2021 average rate base of approximately $1,578.7 million.

**Q.** Why is Peoples seeking rate relief at this time?

**A.** It has been approximately twelve years since Peoples last requested a base rate increase. During that time, Peoples agreed to reduce its base rates by approximately five percent as a result of federal tax reform. By 2021, the Company's existing base rates will not provide sufficient revenues to allow the Company to safely and reliably serve its customers while allowing for the opportunity to earn a fair return on the Company's investment.

**Q.** What was Peoples' return on equity ("ROE") for 2019 and what is the projected ROE for 2020?

**A.** The December 2019 Surveillance Report ROE was 10.00 percent. The projected ROE in the 2020 Forecasted Surveillance Report was 7.51 percent.

**Q.** What is Peoples' projected ROE in the 2021 test year?

**A.** Without rate relief and including the impact of moving the CI/BSR investments into rate base in 2021, the Company projects a ROE of 2.01 percent. Under the scenario of Peoples not filing for rate relief and the CI/BSR staying in place in 2021, the Company projects a ROE of 3.35 percent. These are far below both the Commission's approved 10.75 percent midpoint ROE from the last base rate proceeding and the

Company’s proposed 10.75 percent ROE for this proceeding, as supported in the direct testimony of expert witness Robert B. Hevert.

**Q.** Can you explain the calculation for determining the December 31, 2021, projected test year revenue requirement?

**A.** Yes. The derivation of the Company’s projected revenue deficiency is summarized in MFR Schedule G-5. The 2021 revenue deficiency is determined by multiplying the projected test year rate base by the proposed overall rate of return to arrive at the net operating income (“NOI”) required. The difference between the required NOI and the forecasted projected test year NOI results in the NOI deficiency. The NOI deficiency is then multiplied by the NOI Multiplier, which accounts for income tax gross ups, bad debt expense, and regulatory assessment fees, to determine the forecasted base revenue deficiency.

**Q.** What is the NOI Multiplier being used to determine the revenue deficiency?

**A.** The NOI Multiplier proposed in this case is 1.3361 as shown on MFR Schedule G-4. The NOI Multiplier reflects the corporate federal income tax rate of 21.0 percent in accordance with the Tax Cuts and Jobs Act of 2017 ("TCJA") and the 2021 temporary state of Florida corporate tax rate of 4.458 percent. In addition, the NOI Multiplier incorporates the bad debt rate of 0.3423 percent and the regulatory assessment fee rate of 0.5 percent.

**Q.** Please explain why the state of Florida corporate tax rate is temporary.

**A.** As further discussed in the direct testimony of Company witness Valerie Strickland, on September 12, 2019, the state of Florida issued a corporate tax rate reduction from 5.5 percent to 4.458 percent effective January 1, 2019 through December 31, 2021. On January 1, 2022, the rate will return to 5.5 percent.

**CAST IRON / BARE STEEL RIDER TREATMENT**

**Q.** Please explain how the Company proposes to address its CI/BSR in this rate case proceeding.

**A.** Commission Order No. PSC-2012-0476-TRF-GU ("Order") established the program for accelerating replacement of cast iron bare steel pipe due to safety concerns. In the Order it was contemplated that when Peoples filed its next rate case, the replaced infrastructure recovered through the CI/BSR would be rolled into Peoples' overall rate base and the surcharge would be "reset to zero". To accomplish that in this base rate proceeding, the Company has included in rate base the gross plant, accumulated depreciation and construction work in progress related to the cumulative CI/BSR eligible investments made through December 31, 2020. The net book value of the CI/BSR assets on December 31, 2020 is budgeted to be approximately $200.7 million. In addition, beginning January 1, 2021, the Company has reflected the related depreciation expense and increasing accumulated depreciation, property tax expense and return on the rate base in the calculation of the 2021 revenue requirement.

Although the CI/BSR will be reset to zero and adjusted for any true-up amounts from 2020 on January 1, 2021 in this base rate proceeding, the CI/BSR program will continue until all eligible infrastructure replacements have been made, which was also contemplated in the Order. Therefore, eligible pipe replacement investments budgeted for 2021 and their related costs have been reflected as recoverable through the reset CI/BSR in 2021. Consistent with the terms of the Order, the Company has excluded the first $1.0 million of capital expenditures for replacements in 2021 from recovery through the CI/BSR surcharge. Therefore, the first $1.0 million has been included in rate base.

**Q.** How does the Company propose to handle any over or under-recovery of the 2020 CI/BSR related revenue requirements?

**A.** Consistent with the process approved in the original Order, the Company proposes any over or under-recovery of 2020 CI/BSR revenue requirements be subject to the normal true-up process in 2021.

**Q.** What is the impact on the Company's requested revenue requirement from rolling the CI/BSR investments into rate base?

**A.** Incorporating the revenue requirement related to the $200.7 million net book value of the CI/BSR assets as of December 31, 2020 has an approximate $23.6 million impact on the Company's request, resulting in a total requested base rate revenue increase of $85.3 million. I note, however, that the $23.6 million associated with CI/BSR should not be considered new revenue to the Company, as this is actually revenue that the Company already receives through the CI/BSR surcharge. The incorporation of the CI/BSR revenue requirement for the Company's rate request simply reflects a revenue neutral transfer of the CI/BSR investments made through December 31, 2020, into rate base and resetting the rider to zero asset net book value as of January 1, 2021. Thus, while the transfer of the CI/BSR investments to rate base has a $23.6 million impact on Peoples' requested revenue requirement, the impact on actual company revenue, and its customers' bills, is completely neutral.

**Q.** How did the Company determine that impact to the revenue requirement related to moving the CI/BSR investments into rate base was $23.6 million?

**A.** The Company determined the CI/BSR related impact to 2021 revenue requirement by employing the normal annual calculations used to set the annual CI/BSR surcharge. Pursuant to the Order, the CI/BSR revenue requirement includes the associated depreciation expense, property tax expense and return on the investment. The surcharge calculation was first calculated assuming the CI/BSR was not reset to zero January 1, 2021. Then the surcharge calculation was redone assuming a reset to zero as of January 1, 2021, with only the eligible 2021 infrastructure replacement investments and their associated costs included in the 2021 CI/BSR surcharge. The difference between the two calculations is the $23.6 million.

**BUDGET PROCESS**

**Q.** How did the Company prepare the 2021 projected test year financial data?

**A.** Peoples’ 2021 projected test year was developed using the same process used to develop the Company’s annual budgets, including capital expenditure and income statement forecasts. The generation of the budget is an integrated process that results in a complete set of budgeted financial statements, including income statement, balance sheet and statement of cash flows. The balance sheet is budgeted by starting with the December 31, 2019, actual balances. Balance sheet accounts are then budgeted by either forecasting monthly balances based on past trends or using the forecasted monthly income statement activity, depending on the type of account. Once the balance sheet and income statement have been constructed, a statement of cash flows is generated. This statement determines the Company’s capital structure funding by showing its needs from short-term debt draws, long term bond issuances and equity infusions. The Company’s ability to manage its costs through its diligent and thorough annual budgeting process has been a contributing factor in avoiding a base rate increase for the last 12 years.

**Q.** What are the major components of the projected 2021 budgeted balance sheet?

**A.** The largest component of the 2021 budgeted balance sheet is the net utility plant. Net plant balances reflect the capital expenditures for property, plant and equipment already invested as well as the capital expenditures included in the 2020 and 2021 capital budget. The other major components of the balance sheet and rate base are the accumulated provision for depreciation of plant-in-service and the accounts that make up the allowance for working capital.

**Q.** What are the major components of the projected 2021 budgeted income statement?

**A.** The major components of the income statement include revenues, operations and maintenance (“O&M”) expense, and depreciation expense. The 2021 revenues are supported by Company witness Lorraine L. Cifuentes. My direct testimony will support the Company's 2021 operating expenses.

**Q.** How was the 2021 budgeted income statement developed?

**A.** The 2021 budgeted income statement was prepared by Peoples’ Finance department under my direction and supervision. The Finance department assembled forecasted data prepared by numerous employees who specialize in different areas of the Company's operations. The same accounting principles, methods and practices which the Company employs for historical data were applied to the forecasted data to arrive at the budgeted income statement.

The income statement is developed using all forecasted revenues and other types of income, largely base revenues and the revenues from the cost recovery clauses and CI/BSR. The income statement also contains projections for off-system sales and other operating revenues such as miscellaneous service revenues. To complete the income statement, all operating expenses are accumulated including O&M expense, depreciation expense and property taxes. Interest expense and interest income, as well as all below-the-line items are also considered. Once all pre-tax components are determined, income taxes are calculated to determine final net income.

As further described later in my prepared direct testimony, Peoples' President and the senior management team performed a detailed review of the proposed 2021 O&M expense budget for alignment with Company objectives and strategic initiatives prior to finalizing the Company's 2021 income statement budget. The Company's Board of Directors then approved Peoples 2021 income statement budget on March 16, 2020.

**Q.** Please discuss the Company's process for determining the 2021 budgeted revenues.

**A.** The Company’s Load Research and Forecasting group produces the residential and small commercial customer counts and therm-usage projections. Company witness Cifuentes is responsible for this function and discusses key assumptions used to develop the forecasts in more detail in her direct testimony. As discussed in Company witness Cifuentes’ direct testimony, the Business Development and Accounting Departments collectively prepare the large commercial and industrial revenue forecast at the individual customer level, which is provided to Company witness Cifuentes to be aggregated into the revenue budget. Detailed revenue data by month is generated and provided for inclusion in the income statement.

**Q.** How did the Company prepare the 2021 projected test year O&M expense budget?

**A.** O&M expense was prepared through the Company’s detailed cost center level approach covering all operational areas, corporate departments and intercompany O&M charges for shared services provided by Tampa Electric and Emera. O&M expenses were further budgeted by resource type (payroll, benefits, materials and supplies, outside services, etc.). Payroll expenses were budgeted by position with an allocation of those payroll costs between O&M, capital expenditures, clause recoverable and charges to affiliates as appropriate. Other resource types were budgeted by cost center based on projected activity levels and requirements. To project costs in 2021-year dollars, a salary and wages increase was applied to payroll costs and a general inflation rate was applied to other resource types as appropriate. The 2021 cost projections for pension and post-retirement benefits expense were provided by the Company's external actuarial firm, Mercer.

Prior to finalizing the 2021 O&M budget, Peoples' senior management team reviewed all new labor positions and non-labor resource additions being proposed for alignment with overall Company objectives and strategic initiatives.

**Q.** Is the Company proposing new depreciation rates in this proceeding to be effective in the 2021 projected test year?

**A.** Yes, the Company is proposing new depreciation rates in this proceeding to be effective as of January 1, 2021. The new rates have been determined in the Company's Depreciation Study that has been filed in a separate docket. The Depreciation Study is supported by the direct testimony of expert witness Dane Watson.

**Q.** How did the Company forecast depreciation expense for the 2021 projected test year?

**A.** The Company calculated the test year depreciation expense by applying the Company’s new proposed depreciation rates to the 2021 monthly balances of plant-in-service.

**Q.** Please discuss how property tax expense was budgeted.

**A.** Property tax expense represents payments made by the Company to county governments for ad valorem taxes. The projected expense is a function of forecasted tax rates and the projected values that will be used by the counties to assess the Company's plant assets. As investment in assets grows, property tax expense also grows. As a result, the Company projects that ad valorem property taxes will grow to roughly $16.0 million in 2021 from the $7.6 million included in the 2009 rate case revenue requirements.

**Q.** Please discuss how income taxes were budgeted.

**A.** As supported by Company witness Strickland, income tax expense for the test year was computed on a stand-alone basis consistent with the Company's last base rate proceeding. Projected total income tax expense is a function of forecasted taxable income coupled with the IRS and Florida state tax rules expected to be in place during the test year. All NOI and capital structure amounts reflect reasonable budget projections, consistent regulatory treatments and compliance with the normalization requirements of the Internal Revenue Code.

**NET OPERATING INCOME**

**Q.** How did the Company determine the test year 2021 NOI?

**A.** As previously mentioned, the Company determined its test year NOI by first following its normal detailed annual income statement budgeting process. Adjustments to the budgeted income statement were then applied to determine the test year 2021 NOI.

**Q.** What is the Company’s projected test year 2021 NOI without rate relief?

**A.** As shown on MFR Schedule G-2, page 1, the Company is projecting the 2021 NOI as adjusted to be approximately $40.8 million.

**Q.** Were adjustments to the budgeted income statement were made to determine the 2021 projected test year NOI?

**A.** Yes, adjustments were made reflective of previous Commission directives and policies from Peoples' prior base rate proceedings.

**Q.** Did the Company make any changes in determining its test year 2021 operating expenses?

**A.** Yes. The following changes are being proposed by the Company:
1) Implement new depreciation rates as supported by the Depreciation Study as filed in a separate docket and included in the direct testimony of expert witness Watson,
2) Increase the Company's annual accrual to the storm damage reserve,
3) Increase the amortization expense related to the Manufactured Gas Plant ("MGP") environmental remediation regulatory asset, and
4) Amortize rate case expenses related to this base rate proceeding over a three-year period.

**Q.** What impact does the new proposed depreciation rates have on the 2021 projected test year operating expense included in NOI?

**A.** The overall impact on the 2021 NOI is an increase in depreciation expense of approximately $3.7 million.

**Q.** Why is the Company proposing to increase the accrual to the storm damage reserve?

**A.** In Peoples' last base rate proceeding, the Commission approved an annual storm reserve accrual of $57,500 on the basis of and in accordance with the Incremental Cost and Capitalization Approach ("ICCA") methodology guidance under Rule 25-6.0143, F.A.C. In the 10-year period from 2010 through 2019, Peoples incurred approximately $3.8 million of incremental storm costs using the ICCA methodology while accruing only $575,000. As shown in Document No. 3 of my exhibit, approximately $3.3 million of the recognized storm costs were related to Hurricane Michael, which exhausted the storm reserve. Subsequent to Hurricane Michael, in 2019, Peoples' service areas narrowly avoided the effects of Hurricane Dorian, a major hurricane that threatened the densely populated east coast of Florida. Although some costs were incurred preparing for Hurricane Dorian, the cost of this storm could have far exceeded the effects of Hurricane Michael.

Considering the actual experienced incremental costs over the past 10-year period reflected on Document No. 3 of my exhibit and the potential for major hurricanes to threaten Peoples' service areas across Florida, the Company proposes increasing the storm reserve accrual to $380,000 per year and increasing the $1.0 million cap approved in the Company's last base rate proceeding to $3.8 million. If the storm reserve account balance were to reach this level, Peoples would stop accruing the annual expense amount requested in this rate proceeding.

**Q.** Why is Peoples' proposing to increase the annual amortization expense for MGP environmental remediation costs?

**A.** In Docket No. 19980434-GU and Commission Order No. PSC-1998-0739-FOF-GU issued on May 28, 1998, Peoples was ordered to continue to accrue $640,000 annually and to continue to use reserve accounting to recover the estimated MGP clean-up costs. In 2016, Peoples entered into a settlement agreement approved by the Commission under Docket No. 20160159-GU, which called for Peoples to amortize at least $32.0 million of MGP-related costs during the period 2016 – 2020. The $32.0 million of amortization was achieved by the end of 2018 as part of the settlement agreement approved by the Commission under Docket No. 20180044-GU. The settlements were a recognition by all parties that the $640,000 annual accrual was inadequate to recover the incurred and projected MGP clean-up costs.

As reflected in Document No. 4 of my exhibit, as of December 31, 2019, the Company’s MGP liability is approximately $20.8 million. The Company’s related MGP net regulatory asset reflects the need to recover the $20.8 million MGP liability related to future expenditures plus the over or under-recovery of actual remediation costs already incurred. The over or under-recovery amount is determined by comparing the actual remediation costs incurred less the cumulative amount of MGP-related regulatory asset amortization expense that has been recognized on the Company’s income statement. As mentioned above, the Company did amortize $32.0 million of MGP-related regulatory assets between 2016 and 2018. The accelerated amortization of the MGP-related regulatory asset has resulted in an over-recovered balance of approximately $0.8 million as of December 31, 2019. As shown in Document No. of 4 of my exhibit, the net MGP-related regulatory asset is approximately $20.0 million. Amortizing the approximate $20.0 million of MGP-related net regulatory assets through a $640,000 annual expense would take over 30 years. The Company proposes a more reasonable recovery period of approximately 20 years, or an increase to the annual amortization expense from $640,000 to $1.0 million.

**Q.** What is the rate case expense and amortization being proposed by the Company?

**A.** As reflected in MFR Schedule C-13, the Company has included $552,333 in annual expense for the amortization of approximately $1.65 million in rate case costs over a proposed three-year amortization period. The $1.65 million estimated rate case cost reflects less than a two percent annual percentage increase over the approximate $1.4 million of actual costs incurred in the Company’s prior rate case filed in 2008.

**Q.** What amount of off-system sales margin has been included in the projected test year in determining the Company’s NOI?

**A.** The Company has budgeted approximately $1.3 million of off-system sales’ (“OSS”) net revenues to Peoples in 2021, which is consistent with the Company’s 2019 actual net revenues achieved. This is the most recent annual results reflecting current market conditions and opportunities for OSS margin. It also assumes retaining the sharing mechanism that has been in place since its last base rate proceeding, with 25 percent of OSS net revenues being retained by the Company and 75 percent going to offset expenses recovered through the PGA clause.

**OPERATIONS & MAINTENANCE EXPENSE**

**Q.** What is the largest operating expense impacting the Company's NOI?

**A.** O&M expense is the largest expense item impacting the Company's NOI.

**Q.** What are the functions comprising Peoples' O&M expense?

**A.** Peoples classifies its O&M expense into FERC designated functions including Administrative and General ("A&G"), Distribution, Customer Accounts, and Sales Expense. In addition, the Company has adjusted O&M expenses related to Gas Plant Leased to Others that has been classified as "Other" O&M expense.

**Q.** Does Peoples' O&M expense include A&G charges from Tampa Electric and TECO Services?

**A.** Yes. Peoples' O&M expense includes charges for various shared services provided by TECO Services, Inc. ("TSI") and Tampa Electric. These shared service costs are included in A&G FERC account 930.2 on MFR Schedule G-2, page 18. The services received are primarily corporate shared services consisting of procurement, information technology, telecommunications, human resources, payroll processing, treasury, tax support, legal services, risk management, audit services, real estate, regulatory support, mail room services, bank charges, facility services and rent. Expenses are charged to Peoples at cost pursuant to the TECO Energy, Inc. Cost Allocation Manual (“CAM”).

Costs are either charged as direct costs charged to an affiliate (“Direct Charges”); indirect costs for services assessed to more than one affiliate using one or more formulas for assessment (“Assessed Charges”); or allocated to multiple affiliates (“Allocated Charges”) using a variant of the Modified Massachusetts Method (“MMM”). This MMM for Allocated Charges has been consistently applied since Peoples became part of TECO Energy in 1997 and is consistent with the methodology employed during the Company’s last two base rate proceedings. No cost is allocated or assessed twice to any affiliate.

Beginning January 1, 2020, the TSI shared service functions and employees were assigned to Tampa Electric. The methodology for allocating the costs for shared services to Peoples in the 2020 and 2021 budget is consistent with the methodology used in 2019.

**Q.** What was the amount of MMM Allocated Charges received by Peoples in the 2019 historical base year and 2021 budget?

**A.** As shown in Document No. 2 of my exhibit, Peoples received $3.47 million of MMM Allocated Charges in 2019, as compared to $3.65 million MMM Allocated Charges budgeted for 2021.

**Q.** How do these amounts compare with the MMM Allocated Charges included in the Commission approved revenue requirements in Peoples last base rate case proceeding?

**A.** In the Company’s prior base rate case proceeding, the MMM Allocated Charges included in the final Commission approved 2009 test year revenue requirements was approximately $3.93 million.

**Q.** Does the Company receive charges from its indirect owner, Emera, Inc. (“Emera”)?

**A.** Yes. The Company directly receives Assessed Charges from Emera for certain corporate and strategic support services, shared subscriptions, shared software license fees, and charges for certain Emera executive’s participation on Tampa Electric Company’s Board of Directors. The corporate support includes Sarbanes-Oxley compliance oversight, safety oversight, cyber & general security oversight, environmental policy and programs governance, technical accounting support, and corporate-wide human resource and health promotion initiatives. In addition to the direct Assessed Charges from Emera, Peoples receives Allocated Charges from Emera for corporate governance and strategic support.

**Q.** What were the total costs received from Emera in the 2019 historical base year and the 2021 projected test year?

**A.** The amount of Assessed Charges received from Emera was approximately $0.36 million in the 2019 historical base year compared to $0.51 million in the 2021 projected test year. The amount of Allocated Charges from Emera was approximately $0.73 million in the 2019 historical base year compared to approximately $1.06 million in the 2021 projected test year. All costs received by Peoples from Emera are included in A&G FERC account 930.2 on MFR Schedule G-2, page 18.

**Q.** Has an adjustment been made to allocate Peoples' A&G expenses between the utility and any non-utility affiliates?

**A.** Yes. Consistent with the Company's prior base rate proceeding, Peoples charges a portion of its corporate A&G expenses to its non-utility affiliates. The A&G charges from

Peoples to the non-utility affiliates are based on budgeted expense for the year and are determined based on an allocation methodology using net revenues, payroll, and gross plant in service, in order to calculate a weighted average allocation factor for each entity. Because the A&G charges to the non-utility affiliates are reflected as credits in the actual per-books expenses, no further adjustment is required. MFR Schedule C-6 shows the amount of A&G (and other) expenses that have been allocated.

**Q.** Has Peoples analyzed overall O&M expense since the last rate case proceeding in comparison to the 2019 historical base year?

**A.** Yes, we have analyzed the Company's 2019 historical base year O&M using the "O&M benchmark" approach the Commission uses to analyze the growth of adjusted O&M costs as compared to customer-growth and the CPI inflationary measures published by the U.S. Bureau of Labor Statistics. Adjusted O&M excludes O&M recoverable through clauses and riders.

The adjusted O&M expense for the 2019 historic base year is $107.0 million compared to a calculated benchmark of $99.2 million using the Commission methodology of increasing O&M expenses by the rate of inflation plus customer-growth. The historic base year O&M expense is more than the benchmark by approximately $7.8 million, or 7.9 percent. As discussed later in my testimony, the primary functional areas driving the increase are Distribution and Customer Accounts. The amounts by functional area are detailed on MFR Schedule C-34.

**Q.** Are all the functional areas of the O&M benchmark calculated using the same compound multipliers?

**A.** Yes, all the functional areas of the O&M benchmark were calculated using the same compound multiplier as developed on MFR Schedule C-37, which is 1.5089.

**Q.** What is the benchmark comparison for A&G expense?

**A.** As shown on MFR Schedule C-34, A&G Expense for the 2019 historical base year is approximately $0.6 million lower than the benchmark, or 1.2 percent below the benchmark calculation. Excluding approximately $3.3 million of Hurricane Michael storm costs that were recognized in 2019 coincident with the temporary storm surcharge billings, the adjusted A&G Expense for the 2019 historical base year is approximately $3.9 million lower than the benchmark.

**Q.** Although the adjusted A&G expense for the 2019 historical base year is below the benchmark, are there any A&G expense items that have shown significant increases since the 2007 historical base year?

**A.** Yes. As discussed in Company witness Charlene McQuaid's direct testimony, like many companies in the U.S., health-care costs increases have been a challenge. Since the 2007 historical base year from the prior base rate proceeding, the Company's healthcare cost increased from just over $4.0 million to approximately $7.8 million in 2018 and $6.6 million in 2019. Health-care benefit costs are accounted for in FERC account 926.

**Q.** What is the benchmark comparison for distribution expense?

**A.** As shown on MFR Schedule C-34, distribution expense for the 2019 historical base year is approximately $5.9 million, or 23 percent, more than the benchmark. Company witness Richard Wall discusses the operational items causing the distribution expense in 2019 to exceed the benchmark in his testimony.

**Q.** Please explain the non-operational items causing the 2019 distribution expense to exceed the benchmark as evidenced on Schedule MFR C-38.

**A.** There are two non-operational items causing the 2019 base year Distribution O&M to exceed the Commission benchmark. One is a change in accounting and the other is a non-recurring credit recognized in 2007.

1) Changes in the accounting for vehicle depreciation – Prior to the Company's implementation of its SAP financial system in 2012, depreciation of vehicles stayed in depreciation expense on the income statement. Upon implementing the SAP financial system, the vehicle-related depreciation expense was included in the fleet transportation costs assessment that follows labor charges. As a result, a portion of the vehicle depreciation costs began flowing to O&M expense along with O&M related labor costs. Therefore, the vehicle depreciation expense accounting change is a relocation of expenses on the income statement and not a true increase in overall operating expenses. The amount of vehicle-related depreciation expense in the 2019 O&M expense was approximately $1.5 million.

2) Non-Recurring Credit – In 2007, the Company's FERC account 878 (Meter and house regulator expenses) included an approximate $1.05 million non-recurring credit related to defective meters. After applying the 1.5089 compound multiplier developed on MFR Schedule C-37, the $1.05 million

2007 non-recurring credit results in an approximate $1.58 million reduction to the 2019 Distribution expense benchmark calculated on MFR Schedule C-34.

**Q.** What is the benchmark comparison for Customer Accounts expense?

**A.** As shown on MFR Schedule C-34, Customer Accounts expense for the 2019 historical base year is approximately $1.4 million, or 10.6 percent, more than the benchmark.

**Q.** Why is the Company's Customer Accounts expense exceeding the benchmark?

**A.** The Company's shared SAP customer relationship management and billing system ("CRMB") went into service in 2017. Although the CRMB system is shared with Tampa Electric, all of the asset is recorded on Tampa Electric's books and Peoples is charged an "asset-usage fee" for using the system to manage Peoples' customer accounts. The asset-usage fee is a charge for a portion of the CRMB system depreciation expense incurred by Tampa Electric. Peoples' portion of the depreciation expenses is based on the approximate ratio of Peoples customers to the total Peoples and Tampa Electric combined customers. The asset-usage fee is included in Peoples' O&M

expense in the Customer Accounts expense function. The total amount of CRMB system asset-usage fees charged to Peoples in 2019 was approximately $2.1 million. As shown on MFR Schedule C-38, after adjusting for this item, the Company’s 2019 actual costs are below the benchmark comparison for Customer Accounts expense by approximately $0.7 million, or 5.2 percent.

**Q.** How was the O&M expense budget for 2020 and 2021 developed?

**A.** The Company’s 2020 and 2021 budget for O&M expense was prepared in the detailed annual income statement budget process that I described earlier in my direct testimony. The Company’s Board of Directors approved the 2020 and 2021 income statement budgets, including O&M expense. In addition to the detailed O&M budget, in the MFRs Schedule G-2, pages 10-19, a calculation has been made of O&M expense by FERC account for 2020 and 2021 using the “trending methodology” prescribed by MFR Schedule G-2, adjusting for certain items where trend factors do not capture the projected changes in O&M expense. The comparison of the two O&M methodologies is shown on Document No. 2 of my exhibit.

**Q.** How does the detailed 2020 and 2021 O&M budget compare with the trended FERC O&M budget data on MFR Schedule G-2?

**A.** As shown in Document No. 2 of my exhibit, the difference or unreconciled amount between the detailed 2020 and 2021 O&M budgets and the 2020 and 2021 FERC O&M budget data on MFR Schedule G-2 is approximately $123,000 and $74,000, respectively, which is a difference of approximately 0.1 percent. The differences are reflected as a line item labeled "Unreconciled budget items" in FERC Account 930.2 (Miscellaneous general expenses) on MFR Schedule G-2, page 18. As a result of reflecting the $123,000 and $74,000 as unreconciled budget items in FERC account 930.2, the total FERC O&M calculated using trending on MFR Schedule G-2 for 2020 and 2021 equals the detailed 2020 and 2021 O&M budgets, or approximately $108.3 million for 2020 and $121.3 million for 2021. Excluding the 2021 unreconciled budget items of $74,000, the O&M expense calculated in MFR Schedule G-2 would be higher than the O&M expense determined in the Company's detailed 2021 budget.

**Q.** What trending factors were used in Schedule G-2 to develop the 2020 and 2021 O&M expense amounts?

**A.** Consistent with the Company's prior rate cases, Peoples used the trending factors of payroll only, customer-growth plus inflation, and inflation only. The Company did not consider the trending factor payroll plus customer-growth as done in prior rate cases. Instead, the Company has specifically identified payroll position additions and their impact on the 2020 and 2021 budgeted O&M by FERC account, which is discussed later in my testimony. For inflation, the Company used Moody's Economy.com's 2020 and 2021 forecast for the CPI-U, which was 2.2 percent for both years. Payroll trending includes increases of 3.0 percent for 2020 and 2021, which was provided by the Company's Human Resources department.

**Q.** What are the main drivers for the projected increases in O&M in the 2021 test year?

**A.** Besides inflationary and customer-growth pressures on O&M, the Company is projecting increases due to the following:

- As discussed in Company witness Wall's direct testimony, further operational resources are needed to continue enhancing the safety and reliability of the gas distribution system for the benefit of customers and the public in the communities we serve,
- As discussed in Company witness O'Connor's direct testimony, adding technical resources to provide customers innovative energy solutions related to LNG and RNG and improve the Company's data-analytics capabilities,
- As discussed in Company witness Monica A. Whiting's direct testimony, enhancing our customers' experience through

technology improvements, and

- As discussed in Company witness McQuaid's direct testimony, escalating health care costs.

**Q.** You mentioned that certain O&M expense items were not projected using the trending factors. How are those items reflected on Schedule G-2?

**A.** That is correct. New payroll positions are shown on "Payroll not trended" lines on MFR Schedule G-2, pages 10-19. In addition, there are certain O&M expense items that do not follow the inflation and customer growth trend factors. In those cases, the Company used the "Other not trended" lines on MFR Schedule G-2, pages 10-19 to reflect O&M expense yearly changes from the 2019 actual, 2020 budget and 2021 budget.

**Q.** What are some of these noteworthy "not trended" O&M expense items referred to above?

**A.** Below is a description of the noteworthy "not trended" items included in MFR Schedule G-2, pages 10-19. Document No. 5 of my exhibit summarizes by FERC account the O&M expense items labeled "Other not trended" on MFR Schedule G-2, pages 10-19.

FERC Account 413 – Expenses of Gas Plant Leased to Others – This account includes CNG station O&M expenses budgeted based on contract terms with third parties providing CNG station O&M services.

FERC Account 887 – Maintenance of Mains -The other non-trended items reflect the Company's Transmission Integrity Management Program ("TIMP") costs. As discussed by Company witness Wall, the pipeline integrity compliance costs can vary from year-to-year depending on which pipelines are due for assessment and inspection. Contractors are heavily relied upon to complete these compliance requirements. In 2021, several reassessments are scheduled to be completed on several pipelines totaling approximately $1.96 million. In addition, in 2021 the Company has budgeted approximately $0.15 million for outside engineering assistance related to TIMP risk analysis assessments and plan updates.

FERC Account 903 – Customer Accounts and Records Expense – This account includes asset-usage fees for the companies CRMB system I discussed earlier in my testimony. The non-trended amounts reflect the projected depreciation expense allocated from Tampa Electric to Peoples as an O&M asset-usage fee. The budgeted increase in the asset-usage fee reflects budgeted functionality improvements to the CRMB system that result in additional depreciation expense at Tampa Electric, which in turn increases the asset-usage fees to Peoples. Peoples is not charged a return on the CRMB asset by Tampa Electric. The CRMB asset-usage fees are budgeted to increase from the 2019 actual of $2.1 million to $2.2 million and $2.4 million in 2020 and 2021, respectively.

FERC Account 904 – Uncollectible Accounts – The 2021 bad debt expense of approximately $1.3 million was based on the four-year average write-off percentage. This approach is consistent with that used by in the Company’s past base rate proceedings.

FERC Account 912 – Demonstrating and Selling Expenses – This account primarily reflects the cost of marketing services provided to Peoples by its affiliate TPI.

FERC Account 920 – Administrative and General Salaries – The “Other not trended” amount reflects the Company’s short-term incentive-pay for all employees based on the Company’s annual achievements against pre-established goals. These goals include measures for safety, employee development, customer service, operational performance and financial goals.

The payroll budget for the “payroll not trended” relates to several new roles created in 2020 and 2021 such as the Director of Human Resources, Director of Safety, positions in the LNG and RNG specialist fields to gain industry expertise as discussed by Witness Tim O'Connor in his testimony, contractor safety, regulatory, and business operational support.

FERC Account 924 – Property Insurance – The Other not trended for this account includes the expense recognition for storm costs. As discussed earlier in my testimony, the Company is proposing to increase the annual accrual for the storm reserve from $57,500 to $380,000. In 2019, the Company recognized storm costs related to Hurricane Michael coincident with the storm cost surcharges collected from customers.

FERC Account 925 – Injuries and Damages – Injuries and Damages ("I&D") expense includes the insurance costs and the self-insured or deductible component of legal claims, including adjustments to the I&D reserve for the self-insured portion of claims incurred but not paid. Legal fees related to claims and a portion of the Company's damage prevention efforts are also included in FERC account 925. Regarding general-liability exposure, the Company maintains a $1 million self-insurance or deductible limit.

To determine the claims and related legal expenses in the 2021 budget, the Company prepared an analysis of the past five years' expense in I&D-related activity. Over this period, the dollar value of claims incurred and the reserve account levels have fluctuated significantly, so an average over the five-year period was determined. In 2019, the I&D reserve was adjusted resulting in an approximate $1.7 million expense recognition. The 2021 budgeted I&D-related reserve expense adjustments is approximately $0.2 million. In 2019, the Company incurred approximately $0.9 million of I&D-related legal costs that were non-recurring.

The 2021 budgeted insurance premiums were based on premium estimates from the Company's outside insurance broker, Marsh. Marsh's estimates reflect a large increase in insurance premiums due to changes in insurance market conditions, resulting from deteriorating industry claims experience and Peoples' own claims experience over recent years. In addition, the Company is planning to increase its total liability insurance limits of coverage from $300 million in 2019 to $400 million in 2020 and 2021 in response to the increase in the frequency of severe industry loss events and exposures such as wildfire. Marsh's estimates for total insurance premiums and fees reflects an increase from approximately $2.0 million in 2019 to $3.1 million and $3.8

million in 2020 and 2021, respectively.

FERC Account 926 – Employee Pensions and Benefits – This account includes employee benefits expenses. Although cost for the various benefits provided to employees can vary from year to year, the net expense in FERC account 926 is budgeted to increase from approximately $10.5 million in 2019 to $10.7 million and $10.9 million in 2020 and 2021, respectively. A portion of the gross benefits costs are capitalized with labor or are related to non-base rate recoverable labor activities such as conservation clause. Therefore, these are net amounts. Also included in FERC account 926 is the Company's Long-Term Incentive Plan ("LTIP") costs. The Company's LTIP program is discussed further in the testimony of Witness McQuaid. The projected LTIP expense in 2021 is approximately $1.56 million as compared to $1.96 million in 2019. The LTIP cost and payout was higher in 2019 due to exceeding established targets. The 2021 budget does not assume the targets are exceeded.

**RATE BASE**

**Q.** What are the primary components of Peoples' rate base?

**A.** As detailed in MFR Schedule G-1, page 1, the largest items in rate base are utility plant-in-service and construction work-in-progress ("CWIP"). These amounts are reduced by accumulated provision for depreciation on utility plant. In addition to the plant related balances, the other component of rate base is the allowance for working capital.

**Q.** What is the 2021 projected test year 13-month average adjusted rate base?

**A.** As detailed on page 1 of MFR Schedule G-1, Peoples' 13-month average adjusted rate base as of December 31, 2021, is projected to be $1,578.7 million. This includes moving approximately $200.7 million of CI/BSR investments made through December 31, 2020, into rate base effective January 1, 2021. The nearly $1.6 billion of rate base is an increase of over 180 percent compared to the $560.0 million previously approved in Peoples' last base rate proceeding.

**Q.** How did the Company forecast the 2021 projected test year balances for utility plant and CWIP?

**A.** The balances were projected forward from December 31, 2019, actual balances using the detailed 2020 and 2021 capital expenditures budget described more fully below. In addition to the capital expenditures budget, plant retirements and removal costs were projected based on historical trends.

**Q.** Please explain how Peoples determines its capital expenditure budgets.

**A.** Peoples separates its capital into two categories, specific major projects and recurring expenditures. Normal recurring expenditures are those routine capital costs required to provide service to new customers as well as costs associated with the replacement and/or relocation of existing facilities and equipment. Specific projects generally represent major projects with costs in excess of $500,000. Specific projects include large main expansions or large maintenance projects such as gate station upgrades, large main replacements or major distribution system improvements. Specific projects can also include technology projects such as a software system implementation or upgrade.

Recurring capital expenditures are trended using recent 12-month actual spending data. This includes projecting capital spending for items such as meter sets and services lines, routine maintenance capital, and recurring general plant additions.

**Q.** Does the Company classify the capital spending based on the objective?

**A.** Yes. As discussed by Company witness Wall, Peoples classifies capital spending as growth, sustaining or legacy integrity projects. In addition, with the approval by the Commission to accrue AFUDC starting in 2019, the Company also separates AFUDC eligible projects.

**Q.** Did the Company's Board of Directors approve the capital expenditure budgets?

**A.** Yes. The 2021 capital budget that incorporated 2020 capital budget was approved by the Company's Board of Directors in March 2020.

**Q.** What is the amount of the Company's 2020 capital budget used to produce the 2021 projected test year rate base?

**A.** As reflected in Document No. 6 of my exhibit, the 2020 capital budget is $358.7 million. In addition, the $358.7 million 2020 capital budget is reflected on MFR Schedule G-1, page 23, as the sum of the total Construction Costs of $348.5 million and Cost of Removal of $10.2 million.

**Q.** What is the amount of the Company's 2021 capital budget?

**A.** As reflected in Document No. 6 of my exhibit, the 2021 capital budget is $263.8 million. In addition, the $263.8 million 2021 capital budget is reflected on MFR Schedule G-1, page 26, as the sum of the total Construction Costs of $255.3 million and Cost of Removal of $8.5 million.

**Q.** What was the actual amount of capital expenditures in 2019?

**A.** The 2019 capital expenditures totaled $234.2 million.

**Q.** What are the primary drivers for the increase in 2020 capital budget over 2019 actual spending?

**A.** As further discussed in Company witness O'Connor's and Wall's direct testimonies, important expansion capital projects are under construction in the Jacksonville, Southwest Florida and Panama City service areas to meet increasing customer demand and enhance the reliability and long-term flexibility of the system in these areas, as well as a LNG storage system project in the Miami service area and the Company's first RNG processing facility project. Spending on these five large capital projects in 2020 is approximately $132.0 million and is the primary driver for the increase over 2019 actual spending.

**Q.** What are the other drivers of the capital spending levels in the 2020 and 2021 Budgets?

**A.** As discussed in Company witness Wall's direct testimony, there are several other drivers including general increases in construction costs and the Company's investments in system safety and resiliency and operations technology improvement projects.

**Q.** Regarding the accumulated provision for depreciation, how did the Company project the test year balances?

**A.** The Company started with the actual accumulated provision for depreciation balances as of December 31, 2019. The projected provision for depreciation expense was added and projected retirements and costs of removal were subtracted from the starting accumulated provision for depreciation balances. The projected provision for depreciation expense through December 31, 2020, was based on the Company's current depreciation rates approved by the Commission in Order No. PSC-2018-0501-S-GU. The projected provision for depreciation expense from January 1, 2021 through December 31, 2021 was based on the Company's proposed depreciation rates that were determined in the Depreciation Study supported by the direct testimony of Company expert witness Watson in a separate docket. The projected retirements were based on the same methodology to estimate retirements from plant-in-service, and costs of removal were based on the forecast amount for 2020 and 2021 based on historical trends.

**Q.** What amount of working capital allowance has the Company included in rate base for the 2021 projected test year?

**A.** As shown on MFR Schedule G-1, Page 1, the Company is requesting a net negative $12.0 million in working capital allowance for the 2021 projected test year.

**Q.** What methodology did the Company use to calculate this level of working capital?

**A.** Working capital was developed using the balance sheet method which has been accepted for many years by the Commission. The various components that make up working capital were projected using a variety of methods described in MFR Schedule G-6, pages 2 and 3.

**Q.** How does the 2021 projected test year allowance for working capital compare to the Company's actual 2019 allowance for working capital?

**A.** As shown on MFR Schedule G-1, Page 1, Peoples' 2019 allowance for working capital included in rate base was a net negative $27.5 million compared to the 2021 net negative $12.0 million. The primary driver for the net $15.5 million positive change is related to the significant amount of MGP environmental remediation spending budgeted for year 2020 and 2021. Over or under-recovery of MGP spending compared to the amount amortized is accounted for in an MGP regulatory asset or liability. The MGP spending in excess of the MGP regulatory asset amortization during 2020 and 2021 is approximately $15.0 million, which is most of the $15.5 million change in allowance for working capital.

**Q.** Please describe how the Company determined the 2021 projected test year balance sheet.

**A.** In developing projections for the balance sheet accounts for the 2021 projected test year, the Company employed the same process used in developing its annual budgeted balance sheet. These methods are described on an account by account basis in MFR Schedule G-6. The December 31, 2019, account balances were used as the beginning balances for projecting the 2020 and 2021 balance sheets, with each line item being forecasted through the projected test year. Balance sheet accounts, including Accounts Receivable, Accounts Payable, and Unbilled Revenues, were trended for known patterns of activity that occur in the normal course of business. Finally, for the regulatory clause accounts -- Unrecovered Gas Costs, CI/BSR, and Conservation Cost Recovery -- the Company forecasted the 2021 13-month average balances by rolling forward the detailed projections for the 2020 balances and targeting near zero balances by year-end 2021. The 2020 detailed projections reflect the Company's updated cost projections and Commission approved rates.

**Q.** How did the Company treat clause over/under recoveries in calculating the allowance for working capital?

**A.** The Company's PGA clause is projected to be over-recovered in 2021. Consistent with Commission guidelines, the Company included over-recoveries in working capital as a reduction to rate base. The CI/BSR, energy conservation cost recovery, and competitive rate adjustment are projected to be under-recovered during 2021. In accordance with Commission guidelines, these under-recoveries were deducted from working capital as adjustments.

**Q.** Are there any new adjustments being made to the Company's balance sheet to determine adjusted rate base?

**A.** Yes. The Company has removed from rate base CWIP balances that earn allowance for funds used during construction ("AFUDC"). On July 22, 2019, in Order No. PSC-2019-0291-PAA-GU, the Commission provided the Company with the authority to accrue AFUDC effective January 1, 2019.

**CAPITAL STRUCTURE AND COST-OF-CAPITAL**

**Q.** What are the components of the Company's capital structure?

**A.** Equity, short-term and long-term debt, customer deposits, and accumulated deferred income taxes ("ADIT") are the components in Peoples' total capital structure.

**Q.** What is the cost-of-capital being proposed by the Company in this proceeding?

**A.** As detailed in MFR Schedule G-3, the Company's proposed cost-of-capital is 6.63 percent. The 6.63 percent proposed cost-of-capital is based on a return on equity of 10.75 percent, which is supported in expert witness Hevert's direct testimony and investor sources' capital structure ratio of 54.7 percent equity and 45.3 percent total debt. The proposed cost-of-capital also includes short-term debt costs of 2.80 percent, long-term debt costs of 4.47 percent, customer deposits at a cost of 2.51 percent and ADIT at zero cost.

**Q.** How does the Company's proposed 54.7 percent equity ratio compare with the allowed capital structure in Peoples' 2008 base rate proceeding?

**A.** The proposed capital structure equity ratio of 54.7 percent is consistent with the Commission approved capital structure in Peoples last base rate proceeding.

**Q.** Given the Company's proposed capital structure of 54.7 percent equity, what are the equity infusions from TECO Energy for 2020 and 2021 necessary to achieve this capital Structure.

**A.** The 2020 and 2021 budgeted equity infusions are $180.0 million and $96.0 million, respectively. These equity infusions are the result of the Company's planned capital structure needs based on its expenditures and business requirements and the targeted equity ratio of 54.7 percent. As discussed later in my direct testimony, Peoples' principal objective is to maintain its financial integrity at a level sufficient to provide access to debt capital at reasonable costs.

**Q.** How did the Company determine the cost and amount of long-term debt to be included in the capital structure?

**A.** The 4.47 percent cost of long-term debt reflects the actual cost of outstanding notes, including the actual interest rate and monthly amortization of debt issuance costs, plus the estimated cost of forecasted long-term debt issuances in 2020 and 2021. Considering the targeted equity ratio and assuming a prudent amount of short-term debt draws on the Company's credit facilities, the Company determined that long-term debt issuances of $150.0 million in 2020 and $150.0 million in 2021 would be needed. The estimated long-term debt cost rate on the budgeted 2020 and 2021 30-year bond issuances was 4.20 percent. The rate assumes that Tampa Electric Company's credit ratings are maintained.

**Q.** How did the Company determine the short-term debt cost rate for the 2021 projected test year?

**A.** The short-term debt cost rate of 2.80 percent in 2021 is based on the estimated cost of its credit facilities, which rates are based on London Interbank Offered Rates ("LIBOR") plus credit spreads and program fees. The short-term debt cost rate assumes that Tampa Electric's credit ratings are maintained.

**Q.** How did you reconcile capital structure to rate base?

**A.** The reconciliation of the 2021 projected test year rate base to the 2021 projected test year capital structure is shown on Document No. 7 of my exhibit. Rate base adjustments discussed earlier require associated adjustments to capital structure to keep the two in sync.

First, certain items are adjusted to specific capital structure items to which they are specifically related. These “specific adjustments” include unamortized debt discount and expense (“DD&E”, an adjustment to long-term debt), dividends declared (an adjustment to equity), and property held for future use and non-utility adjustments to rate base (each a specific adjustment to equity). Also, there is an adjustment for other comprehensive income (“OCI”) and the related deferred tax assets (“DTA”) on settled hedges being reflected as long-term debt as the OCI and DTA are related to interest rate swaps on long-term debt issuances.

Second, some items are first specifically adjusted to ADIT for direct impacts and the remainder adjusted over investor sources of capital or pro-rata over all sources of capital. Specific adjustments to ADIT are being made for the competitive rate adjustment receivable and unamortized rate case expense due to their immediate deferred income tax impacts. The CI/BSR follows this treatment because the replacement of legacy pipe is a deductible repair and maintenance cost when placed in service under Internal Revenue Code Section 162.

Third, for the net under-recovery balance related to the PGA, CI/BSR and the conservation cost recovery clause, the under-recovery was removed from short-term debt and deferred taxes because these are the components of the capital structure that are impacted by the shortfall between the clause expense incurred and the clause revenues collected.

Fourth, as previously discussed, beginning in 2019 the Company received approval to accrue AFUDC and Peoples' CWIP on projects deemed eligible to accrue AFUDC has been excluded from rate base. The capital structure for AFUDC and CWIP was adjusted on a pro-rata basis over all sources of capital.

Finally, the remaining items were adjusted to capital structure on a pro-rata basis over investor sources.

**Q.** Was any capital structure adjustment to Deferred Taxes needed to comply with the Internal Revenue Code?

**A.** Yes. There was an adjustment made to deferred income taxes in the capital structure related to the Company employing a projected test year in this rate proceeding. This adjustment was a reduction to ADIT and the offset was applied to investor sources of capital on a pro-rata basis. The justification for this adjustment is described in the direct testimony of Company witness Strickland.

**Q.** How has Peoples' treated OCI and the related DTA in the calculation of the embedded cost of long-term debt noted above?

**A.** As noted above and summarized on MFR Schedule G-3, Page 3, the Company's embedded cost of long-term debt is 4.47 percent for the 2021 projected test year. On this schedule, the Company appropriately adjusted long-term debt balances for any unamortized debt issuing expenses as well as any unamortized debt discounts or premiums, which is standard practice for the Commission.

In addition, the Company has reflected a small amount of remaining unamortized OCI and related DTA as an adjustment to the long-term debt balances in calculating the embedded cost of long-term debt. These balances arose from the settlement of interest rate swaps ("hedges") placed in advance of debt issuances. The remaining balances in OCI and DTA related to these hedges will be amortized into interest expense over the life of the related debt. Accordingly, for purposes of calculating the embedded cost of long-term debt, the unamortized portion of OCI and DTA related to these hedges was treated as an adjustment to long-term debt in the same manner as would occur for debt issuing expenses, discounts, or premiums.

**Q.** Do these adjustments to rate base and capital structure impact NOI?

**A.** Yes. After all these adjustments were made, income tax expense was adjusted to reflect the appropriate amount of interest expense based on the amount and cost of debt in the capital structure that was synchronized to the rate base.

**Q.** Did Peoples make a parent company debt adjustment as contemplated in *Rule* 25-14.004 (F.A.C.)?

**A.** No. As discussed in Company witness Strickland's direct testimony, the Company has not included a parent company debt adjustment in determining the revenue requirement.

**Q.** How does Peoples' 2019 historical base year cost-of-capital compare to the Commission approved cost-of-capital in Peoples' last base rate proceeding?

**A.** The cost-of-capital or average rate of return reported in the Company's December 2019 earnings surveillance report using the Commission approved midpoint of 10.75 percent return on equity was 6.61 percent, which is shown in MFR Schedule D-1, page 1. This compares to the Commission-approved average rate of return in Peoples' last base rate proceeding of 8.52 percent, or a decrease of about 22.0 percent.

**Q.** How has the Company been successful in decreasing the cost-of-capital by approximately 22.0 percent?

**A.** First, financial management of bond issuances has resulted in the Company lowering the average long-term debt cost rate from 7.20 percent in the last base rate case proceeding to 4.73 percent in 2019. This success is attributable to the Company's strong credit profile and the constructive utility regulation in Florida, which has allowed the Company to prudently access capital at very favorable interest rates. Second, since the Company's last base rate proceeding the Commission approved the reduction of customer deposit rates for residential and commercial customers to 2.0 percent and 3.0 percent from 6.0 percent and 7.0 percent, respectively. Third, Peoples has significantly benefited over the last 12 years from increasing the zero-cost accumulated deferred income taxes ADIT component in its adjusted capital structure from 4.24 percent to 16.25 percent in 2019. As discussed in Company witness Strickland's direct testimony, accelerated tax depreciation and tax repairs deductions are the largest components of the increase in ADIT.

**Q.** Please explain how TCJA of 2017 has impacted the ADIT balances included in the Company's capital structure?

**A.** As indicated in Company witness Strickland's direct testimony, the TCJA eliminated bonus depreciation tax deductions. This means that the Company is producing less deferred taxes as it is now using the Modified Accelerated Cost Recovery System ("MACRS"). As mentioned above, ADIT are considered a zero-cost source of capital in Peoples' capital structure. Since the Company's rate base and capital structure are synchronized in the ratemaking process, a relative reduction in the amount of zero-cost ADIT must be made up by relatively higher amounts of debt and equity, both of which have a cost. The financial equity ratio can remain constant, but the relative reduction in the dollar amount of ADIT must be met with increased debt and equity dollar support.

**Q.** What impact did the TCJA have on operating cash flows?

**A.** The TCJA decreased Peoples' operating cash flows as a result of the flow back of excess deferred taxes to its customers plus the elimination of bonus depreciation for regulated utilities. The flowback of excess deferred taxes was included in Peoples' $11.6 million rate reduction that went into effect on January 1, 2019, through Commission Order No. PSC-2018-0501-S-GU. The effect of the TCJA phase-out of bonus depreciation for regulated utilities reduced deferred taxes and increased current taxes payable, which reduces operating cash flows and adversely impacts Peoples' credit metrics.

**Q.** In summary, what overall impact did TCJA have on the Company's financial condition going forward?

**A.** The TCJA impacted Peoples' financial integrity in three ways; 1) it changed Peoples' capital structure as mentioned above; 2) over time it will increase the overall weighted average cost-of-capital due to the higher cost of funding Peoples' capital structure with equity and debt components; and, 3) it has decreased the Company's operating cash flows.

**Q.** What credit rating is Peoples targeting in the future and why?

**A.** Peoples' financial objective is to maintain its current credit ratings of “BBB+” by Standard & Poors, “A3” by Moodys Investor Services and “A” by Fitch Rating Inc. Maintaining these ratings is very important since the Company will require continued access to the capital markets, at reasonable terms, to finance its significant planned infrastructure investments. In addition, due to TCJA impacts mentioned above, a higher percentage of capital expenditure funding must come from investor sources. Maintaining the equity ratio at 54.7 percent with a midpoint ROE of 10.75 percent should produce credit ratings’ parameters for the Company that support maintaining the BBB+, A3 and A ratings, respectively.

**Q.** Please describe the pre-tax interest coverage ratios as reported in MFR Schedules G-3, page 9, and D-11.

**A.** As shown on MFR Schedule G-3, page 9, without rate relief Peoples’ the pre-tax interest coverage ratio (excluding AFUDC) in 2021 is projected to be 1.87 times. This same coverage ratio averaged approximately 5.05 times in the 2015 through 2019 period, which can be seen on MFR Schedule D-11, page 1. The decline in 2021 to 1.87 times coverage ratio is driven by the revenue deficiency reflected on MFR Schedule G-5. Absent rate relief the Company’s financial indicators in 2021 do not support maintaining the current credit rating. As shown on MFR Schedule G-3, page 9, with rate relief the pre-tax interest coverage ratio (excluding AFUDC) is 4.99 times and is consistent with the 2015-2019 coverage ratios.

**SUMMARY**

**Q.** Please summarize your prepared direct testimony.

**A.** The Company has not filed for a base rate increase for 12 years while improving compliance and safety metrics and achieving award winning customer satisfaction ratings. The Company has made significant infrastructure investments and added resources to achieve these improvements. The Company has also made significant reductions to its overall cost-of-capital through successfully lowering long-term debt costs and significantly increasing its funding of capital structure through accumulated deferred taxes.

I have discussed the process and details related to budgeting the 2020 and 2021 operating and capital expenditures required to safely and reliably serve Peoples' customers and communities. Projected revenue levels, coupled with projected cost increases and the increasing demands of operating the gas distribution system, result in low forecasts for NOI and ROE. Without rate relief, the Company's ROE and financial integrity will weaken.

For 2021, without rate relief and moving $200.7 million of CI/BSR-related investments into rate base in this base rate proceeding, the Company's ROE would be a very low 2.01 percent. This is well below the lowest point of Peoples' allowed ROE range and is unsustainable.

Therefore, Peoples is requesting a base revenue increase of $85.3 million or an incremental amount of $61.7 million after considering the revenue neutral shift of $23.6 million related to CI/BSR. The financial basis for this revenue requirement is a weighted average cost-of-capital of 6.63 percent, which includes a 10.75 percent ROE and a financial equity ratio of 54.7 percent. The requested ROE and equity ratio are necessary for the Company to maintain its financial integrity and current credit ratings that provide uninterrupted access to reasonably priced debt capital.

**Q.** Does this conclude your prepared direct testimony?

**A.** Yes, it does.

(Whereupon, prefiled direct testimony of Valerie Strickland was inserted.)

**PEOPLES GAS SYSTEM**
**DOCKET NO. 20200051-GU**
**FILED: 06/08/2020**

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

**PREPARED DIRECT TESTIMONY**

**OF**

**VALERIE STRICKLAND**

**POSITION, QUALIFICATION, AND PURPOSE**

**Q.** Please state your name, address, occupation and employer.

**A.** My name is Valerie Strickland. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed by Tampa Electric Company ("Tampa Electric") as the Director of Corporate Tax.

**Q.** Please describe your duties and responsibilities in that position.

**A.** As an employee of Tampa Electric, I provide U.S. tax services which are included in shared services that Tampa Electric provides to U.S. affiliates. I am responsible for the preparation and filing of all tax returns, all tax accounting for both internal and external purposes, all tax planning as well as managing all federal and state tax audits for the Emera U.S. affiliates, which include Peoples Gas System ("Peoples" or the "Company"). The only taxes I do not oversee are payroll taxes, which are the responsibility of Tampa

Electric's payroll department.

**Q.** Please provide a brief outline of your educational background and business experience.

**A.** I was educated in Europe where I received a master's degree in Accounting & Finance from the "Institute de l' Administration and Gestion" in Paris, France. Upon graduation in 1992, I joined Coopers & Lybrand LLC, an independent accounting firm, as a tax professional. In 1998, Coopers & Lybrand LLC merged with Price Waterhouse and became Price Waterhouse Coopers LLP ("PwC"). I continued to work for PwC as a Tax Manager until I joined the TECO Energy Tax department as a Manager, Corporate Tax in 2000. Since then, I have focused my attention on the preparation of U.S. federal and state income tax returns for the TECO Energy, and now the Emera, U.S. companies and have gained substantial utility tax industry knowledge and experience. I am also an active participant of both the Tax Analysis and Research Subcommittee of the Edison Electric Institute ("EEI") as well as an active participant of the EEI Taxation Committee, serving as Chair of the Committee for 2020.

**Q.** Have you previously testified before the Florida Public Service Commission ("Commission")?

**A.** Yes. I have testified and filed testimony before this Commission in two dockets. The first docket was in connection with Peoples' filing for consideration of the tax impacts associated with the Tax Cuts and Jobs Act of 2017 ("TCJA") under Docket No. 20180044-GU. The second docket, Docket No 20180045-EI was filed in connection with the tax impacts of the TCJA for Tampa Electric.

**Q.** What are the purposes of your direct testimony in this proceeding?

**A.** My prepared direct testimony covers the following areas:
(1) I will testify on the computation of income tax expense and accumulated deferred income taxes ("ADIT") and the parent debt adjustment calculation set forth in the Company's Minimum Filing Requirement ("MFR") schedules.

(2) I will also testify on the calculation of income tax expense and ADIT included in the MFRs for the 2021 projected test year, which is the test year for this proceeding. My prepared direct testimony on the 2021 projected information will address whether the 2021 projected income tax expense and ADIT have been determined using a methodology consistent with the actual 2019 income tax calculations and consistent with the 2021 projected test year cost of service. My

prepared direct testimony will also address how the income tax expense and ADIT calculations are consistent with the specific Internal Revenue Code (“IRC”) and Income Tax Regulations covering 2021 projected test year.

**Q.** Have you prepared an Exhibit to be introduced in this proceeding?

**A.** Yes. Exhibit No. (VS-1) was prepared under my direction and supervision. My Exhibit consists of 2 documents, entitled:

| | |
|---|---|
| Document No. 1 | List of Minimum Filing Requirement Schedules (“MFRs”) - Sponsored |
| Document No. 2 | Calculation of IRC Required Deferred Income Tax Adjustment |

The information in the MFR schedules listed in Document No. 1 of my exhibit are based on the business records of the company maintained in the ordinary course of business and are true and correct to the best of my information and belief.

**ACCOUNTING FOR INCOME TAXES**

**Q.** Can you please describe how income tax expense was computed for the 2021 projected test year?

**A.** Yes. Statement 109, Accounting for Income Taxes ("FAS 109") now codified as Accounting Standards Codification 740 ("ASC740") provides guidance on accounting for income taxes. There are several components to the calculation. The first component is "current" income tax expense, representing the estimated amount of current year income taxes payable based on current year taxable income. Taxable income for the year is determined in accordance with the IRC and is the amount reflected on the income tax return for the year. The IRC contains procedures for determining if and when an item is "taxable" or "deductible." The IRC rules for determining what is taxable or deductible (and therefore what is included in the tax return for the year) may differ from what is reportable as "revenue" or "expense" under Generally Accepted Accounting Principles ("GAAP"). For instance, certain expenses recorded on the financial statements under GAAP in one year may be deductible on the tax return in a different period. There are also instances where the amounts shown as deductions on the tax return in one year are not reflected on the financial statements until a later year. Differences between the book treatment and the tax return treatment of revenues and expenses result in different balances of book and tax assets and liabilities on the respective book and tax balance sheets. These differences are referred to as temporary differences.

**Q.** Provide an example of a book/tax temporary difference.

**A.** When a company acquires a fixed asset, that asset is depreciated for book purposes over its estimated useful life in a systematic and rational manner. Most utilities use the straight-line depreciation method to determine book depreciation expense. For income tax purposes, that same asset may be depreciated for determining taxable income on the income tax return using an accelerated method permitted under the IRC. When the annual depreciation charges for book and income-tax purposes are compared each year, there will likely be differences between the annual book and tax depreciation amounts. However, given the same capitalized asset cost, over the life of the asset total depreciation will be the same. This is because depreciation charges under both the accounting rules and the IRC are meant to "recover" the capitalized asset cost. Another example of a book/tax temporary timing difference is tax repairs. Internal Revenue Service (“IRS”) guidance in 2009 effectively allowed tax expense deductions for certain repairs that were previously capitalized for tax purposes. Repairs tax deductions are pursuant to Section 162 and 263(a) of the IRC. These code sections allowed the Company to prospectively take a current tax deduction for amounts which would have been previously capitalized as plant additions for tax purposes and depreciated for tax purposes. Together, tax depreciation and tax repairs' deductions are the largest book/tax timing differences of the Company.

Another example of a temporary book/tax difference is the accrued expense recorded on the books for other post-employment benefit costs. These are not deductible for income tax return purposes until they are paid or settled. In this example, the book accrual/expense occurs in advance of the tax deduction.

A third example is contributions in aid of construction, which are generally considered taxable when received for income tax purposes. However, for book purposes they are recorded as a reduction of the property, plant and equipment.

**Q.** How are differences between the book treatment and income tax treatment of these types of transactions accounted for under FAS 109?

**A.** In addition to the calculation of current tax expense (the estimated amount of income taxes included on the tax return for a particular year) FAS 109 requires a calculation of the tax expense on temporary differences. The income tax component resulting from applying the income tax rate to temporary differences is known as "deferred tax expense." Because the financial statements reflect accrual accounting, the income tax expense calculation must reflect the liability for income taxes payable in the future as a result of transactions recorded in the financial statements currently. Thus, income tax expense under GAAP includes both a currently payable component as well as a deferred income tax component. In the regulated environment, the process of recording deferred income taxes on temporary differences is often referred to as "comprehensive inter-period income tax allocation" or "normalization".

**Q.** Does the ADIT balance represent an obligation for future income taxes at the balance sheet date?

**A.** Yes. ADIT amounts are taxes that are expected to be paid in the future based on transactions recorded in the financial statements today. The purpose of deferred income tax accounting is to reflect in the financial statements the tax effects (both current and deferred) of the assets, liabilities, revenues and expenses recorded in the financial statements. As I previously mentioned, tax repair deductions and accelerated tax depreciation create the largest timing differences. Therefore, their related ADITs are major components of the total ADIT.

The creation of large ADIT was the result intended by Congress when it changed the IRC to permit the use of accelerated tax depreciation in the Tax Reform Act of 1986. Congress felt that by being allowed to accelerate depreciation deductions (and thereby reduce current income tax payments), companies would lower the financing costs of their investment in capital assets more quickly and thus would be incented to incur such expenditures. Additionally, beginning in 2002 and through 2017, Congress enacted a series of tax law changes to further stimulate the economy, allowing companies to deduct the eligible cost of assets placed in service, referred to as bonus depreciation, at a rate of 30 percent and up to 100 percent for certain years. For accounting purposes, using up the tax basis of capital assets is both a cost to be recognized in the financial statements when claimed (deferred tax expense) and a liability for future taxes due when the turnaround occurs, and book depreciation exceeds tax depreciation

**Q.** Are all book/tax differences “temporary differences” and simply a matter of when the item is included on the tax return versus when the item is shown on the Financial Statements?

**A.** No. Certain items of revenue and expense are treated differently for financial reporting purposes than for income tax purposes. These are referred to as permanent differences.

An example of a permanent difference is the cost of meals and entertainment that are reported as expenses in the financial statements but, based on the IRC, are not completely deductible in determining taxable income on the income tax return. The non-deductible portion of the meals and entertainment expense would be considered a permanent difference, impacting the total tax expense recorded on the Financial Statements.

**RATEMAKING TREATMENT OF INCOME TAXES**

**Q.** Has the Commission taken a position on the appropriateness of deferred income tax accounting?

**A.** Yes. The Commission has long acknowledged that normalization is appropriate for revenues and expenses that are recognized at different times for book and tax purposes. The normalization accounting method involves (1) setting up a deferred tax reserve for the difference between depreciation expense used by regulators to determine the cost of service (normally the straight line method) and the accelerated method used for calculating the income tax on income tax returns, and then (2) drawing down that reserve in later years as the accelerated depreciation reverses. The main objective of normalization is to protect future years' customers from paying abnormally high utility rates because they have to pay for both the utility's current year costs and the reversal of the tax benefits that their predecessors enjoyed. As a result, normalization results in proper allocation of tax expense between current and future customers while considering the time value of the savings resulting from deferred tax payments made as a result of book to tax timing differences. As I discussed earlier, accelerated depreciation is the major component of the total ADIT balance, which is accounted for as a zero-cost source of capital in the cost of capital computation thereby giving the benefit of reduced financing costs to ratepayers.

**Q.** Has the Federal Energy Regulatory Commission ("FERC") taken a position on the appropriateness of deferred income tax accounting?

**A.** Yes. FERC concluded in Orders 144 and 144A that deferred tax accounting was appropriate. FERC has required deferred tax accounting since the issuance of those orders in the 1980's.

**Q.** Does the IRC contain requirements addressing deferred income tax accounting?

**A.** Yes. The IRC contains specific requirements that are applicable to public utility property. These requirements, in effect, mandate that in order for a public utility to be eligible to claim accelerated depreciation for income tax purposes, the regulator must permit recovery of deferred income taxes on the difference resulting from using accelerated depreciation for income tax purposes and straight line depreciation for book purposes. In other words, the use of the flow-through accounting method for the book/tax depreciation difference would cause a "normalization violation."

The penalty for violating the normalization requirements is the loss of the ability to claim accelerated depreciation for income tax purposes on all assets as of the violation date and on subsequent additions. It is a severe penalty.

**Q.** Are investment tax credits (“ITCs”) applicable to Peoples for the 2021 projected test year?

**A.** No. In the Company’s 2008 base rate proceeding, filed under Docket No. 20080318-GU, Peoples had an unamortized balance of $2,047 for projected year 2009. The Company fully amortized its ITCs in 2011, therefore, there is no remaining unamortized balance showing as zero cost of capital in the 2021 projected test year.

**INCOME TAX MFRS**

**Q.** Is the income tax expense reflected in the 2019 historical base year and the 2021 projected test year MFRs computed appropriately?

**A.** Yes. Federal and state income tax expenses have been correctly computed in the income statement in accordance with Generally Accepted Accounting Principles ("GAAP") and the requirements of the Commission. In addition, the computed income tax expenses for 2019, 2020 and 2021 conform with the requirements of the IRC, including the special provisions applicable to utilities.

Peoples' income tax provision has been determined using comprehensive inter-period income tax allocation. Each dollar of revenue and each dollar of expense have inherent tax consequences. The Company's tax computation is based on the revenues and expenses associated with the provision of its regulated utility service to its Florida ratepayers. In this manner the tax expense included in the revenue requirement calculation is the appropriate tax expense reflecting the tax consequences of the costs and revenues included in the establishment of the revenue requirement.

**RECENT CHANGES IN TAX LAW**

**Q.** Have any recent changes in federal income tax laws been considered in this proceeding?

**A.** Yes. The TCJA was enacted by the U.S. Congress on December 20, 2017 and was signed into law by the President on December 22, 2017. The TCJA amended the IRC and includes the most significant set of changes to the federal income tax laws since enactment of the Tax Reform Act of 1986. The TCJA made major changes in many areas of our nation's tax laws, some of which directly affect regulated utilities like Peoples.

**Q.** What changes to the IRC in the TCJA have made the biggest impact on the Company?

**A.** Effective January 1, 2018, the most significant changes in the TCJA to regulated utilities and their ratepayers can be summarized as follows:

(a) The TCJA reduced the federal corporate income tax rate from 35 percent to 21 percent effective January 1, 2018.

(b) The TCJA exempted regulated utilities from the immediate expensing of certain capital additions and applies the Modified Accelerated Cost Recovery System ("MACRS") rules to regulated utility property additions, without a provision for "bonus" (accelerated) tax depreciation. Prior to TCJA, companies were allowed a 50 percent bonus depreciation deduction for assets placed in service prior to 2018. The 50 percent bonus deduction was also applicable for assets placed in service in 2018 for which a binding contract was entered into before September 27, 2017. This loss of bonus tax depreciation on plant additions has a significant impact with regulated utilities now limited to MACRS, with no bonus tax depreciation, reducing the amount of available ADIT.

(c) The TCJA exempted regulated utilities from an interest deductibility limitation.

(d) The TCJA included normalization provisions for public utility property that requires application of the Average Rate Assumption Method ("ARAM") to the flow-back of "protected" excess deferred income taxes.

**Q.** Please describe how the TCJA was taken in consideration for this filing.

**A.** The Company calculated its current and deferred federal income tax expense using a federal tax rate of 21 percent. Additionally, the Company has estimated the flowback of protected and unprotected excess deferred taxes in accordance with my direct testimony filed in Docket No 20180044-GU. Protected excess deferred taxes have been calculated using the ARAM and the unprotected excess deferred income taxes are being amortized using a 10-year straight line method. The ARAM flowback can vary year over year as the reversal is highly dependent on book depreciation activity. Excess tax benefits are only computed when book depreciation exceeds tax depreciation. This analysis is done on an asset-by-asset basis. If book depreciation exceeds tax depreciation on an asset, then ADIT is reversed based on the historical tax rates used to record the original ADIT.

**Q.** Have any recent changes in state tax policy been considered in this proceeding?

**A.** Yes. On September 12, 2019, the Florida Department of Revenue issued a Tax Information Publication ("TIP") announcing that the Florida corporate income tax rate was reduced from 5.5 percent to 4.458 percent effective retroactive to January 1, 2019, and continuing in effect through December 31, 2021 (State Tax Rate Change). The TIP indicates that the Florida corporate income tax rate will return to 5.5 percent, effective January 1, 2022. It also indicates that further reductions in the tax rate are possible for calendar years

2020 and 2021. The Department of Revenue's authority to reduce the state corporate income tax rate is contained in Section 220.1105, Florida Statutes.

**Q.** What steps has the Company taken to properly account for the impact of this state rate change?

**A.** Effective for the reportable balance sheet date of September 30, 2019, the change in the state rate was made in accordance with ASC740 and ASC980 (Accounting for regulated Operations) and Rule 25-14.013 Par (10), Florida Administrative Code ("F.A.C."). The Company remeasured its state ADIT balances and calculated the related excess ADIT balances to reflect the income tax rates expected to be in effect in the period the timing differences are expected to reverse. In this case, ASC740 and Rule 25-14.013, F.A.C., require the Company to recalculate or revalue accumulated deferred state income taxes as of December 31, 2018 arising from timing differences that are expected to reverse in calendar years 2019, 2020 and 2021 at the 4.458 percent state corporate income tax rate for those years. The State Tax Rate Change is temporary and the state corporate income tax rate is expected to return to 5.5 percent effective January 1, 2022, so accumulated deferred state income taxes on the Company's books as of December 31, 2018, arising from timing differences that are expected to reverse after December 31, 2021, need not be recalculated, because they were recorded using a 5.5 percent state income tax rate, which is the rate expected to be in effect after they reverse. Based on the current 4.458 percent state income tax rate, the amount of “excess” accumulated deferred state tax reserves (calculated based on timing differences expected to reverse in 2019, 2020 and 2021) as of December 31, 2019 was estimated to be $940,000. This amount is reflected on page 2 of MFR C-25. These excess deferred state income taxes are “unprotected”. As I stated above, the lower state income tax rate that was enacted effective 2019 is temporary through 2021. Because of the known and measurable nature of the 2022 state income tax rate increase being outside the 2021 projected test year, the Company had two alternatives to address this change. The first one would be to calculate the 2021 projected test year revenue requirements using the higher state income tax rate of 5.5 percent. Peoples’ 2021 revenue requirement would increase, reflecting a Net Operating Income multiplier of 1.3509 as compared to the 1.3361 shown on MFR G-4, sponsored by Company witness Sean P. Hillary, and higher income taxes of approximately $167,500. The second alternative would be to allow the Company to reverse the excess state deferred income taxes of $940,000 in 2022, which would offset the expected incremental state tax expense at the 5.5 percent rate in 2022.

The Company proposes to use the second alternative as it is a fair and reasonable solution for both its customers and the Company. Therefore, the Company has reflected the temporary 4.458 percent state tax rate in the 2021 revenue requirements that are discussed in the prepared direct testimony of witness Hillary.

**IRC REQUIREMENTS FOR 2021 PROJECTED TEST YEAR**

**Q.** In addition to the MFR schedules relating to income tax expense, are you testifying on any other issues?

**A.** Yes. My prepared direct testimony addresses one further adjustment that needs to be made to comply with the normalization requirements of the IRC when a projected or forecast test period is used.

The ADIT balances on MFR Schedule G-1, page 8 are based on a 13-month average of projected balances. However, the IRC requirements in this situation require a specific computation to determine the maximum amount of ADIT to be treated as zero-cost capital in the cost of capital calculation. The specific computation is shown on Document No. 2 of my exhibit as a reduction to deferred taxes in the amount of $1,441,261, which is included in the specific adjustment of $7,147,994 on MFR Schedule G-3, page 2. This adjustment is only required for accumulated deferred income taxes recorded in Account 282, net of the FAS 109 component, because this account includes the deferred taxes governed by the (“IRS”) normalization rules.

**Q.** Please discuss the projected test year normalization requirements.

**A.** Under United States Treasury Department Regulation (“U.S. Treasury Regulations”) § 1.167(1)-1, when a projected test period is used to set rates and the newly determined rates are expected to be in effect for all or a portion of that test period, the utility plant ADIT additions in the portion of the test period in which the new rates are expected to be in effect must be pro-rated over the period for which the new rates are expected to be in effect.

In this filing, the projected test period is the year ending December 31, 2021. Collection of the new rates is expected to start on January 1, 2021. Therefore, the new rates are expected to be in place for the entirety of the projected test year. As a result, January through December 2021 utility plant ADIT additions must be pro-rated. The projected test year utility plant ADIT additions are pro-rated using a ratio in which the numerator is the number of days remaining in the projected test year, and the denominator is the number of days during which the new rates are expected to be in effect in the projected test year. Because the Company closes its books on a monthly basis, the proration is also done on a monthly basis. As a result, January 2021 ADIT additions are prorated using a ratio of 335/365, February 2021 ADIT additions are prorated by 307/365, and so on until December 2021 additions are prorated by 1/365.

**Q.** How did Peoples address this requirement in determining the proper level of accumulated deferred taxes to be treated as cost free capital in the 2021 projected test year, ending December 31, 2021?

**A.** Peoples first determined the monthly projected balances for accumulated deferred income taxes for the year 2021. The monthly changes to accumulated deferred income taxes were based on the specific forecast of book and tax depreciation throughout the 2021 projected test year. These amounts were used to populate the 2021 projected test year MFRs related to monthly ADIT in accordance with the Commission’s F.A.C. Rules. Month-end ADIT balances from December 2020 through December 2021 are shown on MFR Schedule G-1, pages 7 and 8, and a 13-month average is computed. The 13-month average ADIT balance is then summarized on MFR Schedule G-3, page 2.

As explained previously, the average ADIT balance determined in this manner does not comply with the pro rata U.S. Treasury Regulations. The U.S. Treasury Regulations require that a pro rata calculation be used to determine the maximum amount of ADIT to be treated as cost free capital in the cost of capital computation.

Document No. 2 of my exhibit contains the required calculation. The monthly changes to ADIT were identified based on the specific forecast of book and tax depreciation throughout the 2021 projected test year.

Next, a 13-month average of the prorated monthly change in the ADIT balances for the test period was computed. This amount was compared to the 13-month average non-prorated 2021 monthly changes in the ADIT balance reflected on MFR Schedule G-1 pages 7 and 8 and MFR Schedule G-3 page 2 and an adjustment of $1,441,261 was computed. This adjustment is reflected in the prepared direct testimony of witness Hillary and is included in his Exhibit No. (SPH-1), Document No. 7, entitled 2021 Projected Test Year Reconciliation of Capital Structure to Rate. This adjustment is necessary to state the projected 2021 ADIT balance, which is treated at a zero-cost capital, at the level required to comply with the forecast test period requirements as set forth in U.S. Treasury Regulation Section

1.167(l)-1.

**Q.** What are the consequences if Peoples does not follow the pro rata rules of the IRS with respect to forecast test period ADIT?

**A.** Noncompliance with the U.S. Treasury Regulations would result in a form of flow through that violates the normalization requirements of the IRC. As I explained previously, the penalty for violating the normalization requirements is the loss of the ability to claim accelerated depreciation on all public utility property.

**PARENT DEBT ADJUSTMENT**

**Q.** Please describe the ownership and corporate structure of Peoples.

**A.** Peoples is a business unit of Tampa Electric Company ("Tampa Electric") that for purposes of regulation by the Commission operates as a separate entity. Tampa Electric is a wholly owned subsidiary of TECO Energy, Inc., which in turn is a wholly owned subsidiary of Emera U.S. Holdings, Inc. ("EUSHI"). EUSHI is ultimately a wholly owned subsidiary of Emera Incorporated ("Emera"). Emera is headquartered in Halifax, Nova Scotia, Canada and is publicly traded on the

Toronto Stock Exchange.

**Q.** Does Peoples participate in a consolidated income tax return with other Emera companies?

**A.** Yes. Peoples is a member of the U.S. consolidated group owned by EUSHI and files a U.S. consolidated income tax return with EUSHI and the other subsidiaries under the EUSHI umbrella.

**Q.** Based on the corporate structure described above, what entity did you consider for determining the parent debt adjustment?

**A.** EUSHI. Rule 25-14.004 Effect of Parent Debt on Federal Corporate Income Tax of the F.A.C. provides that ”the income tax expense of a regulated company shall be adjusted to reflect the income tax expense of the parent debt that may be invested in the equity of the subsidiary where a parent-subsidiary relationship exists and the parties to the relationship join in the filing of a consolidated income tax return”. Specifically, paragraph (2) of this rule provides that “where the regulated utility is a subsidiary of tiered parents, the adjusted income tax effect of the debt of all parents invested in the equity of the subsidiary utility shall reduce the income tax expense of the utility”. The Company first looked at TECO Energy, its first-tier parent, which has not had any debt on its balance sheet for many years. The Company also looked at the books of EUSHI as EUSHI is the ultimate parent company which files the U.S. consolidated tax return. Since EUHSI is the highest tiered parent in the consolidated income tax return, Peoples used the capital structure of EUSHI parent for the purpose of calculating the parent debt adjustment.

**Q.** Has Peoples made a parent debt adjustment in the 2021 projected test year in accordance with Rule 25-14.004, F.A.C.?

**A.** No.

**Q.** Why not?

**A.** For the 2021 projected test year, EUSHI will not have any debt on its balance sheet for which it will claim any interest expense deductions on its U.S. consolidated income tax return. In the past, EUSHI had a number of interest-bearing loans from U.S. affiliates not associated with any TECO Energy companies. These intercompany loans were restructured in 2019 and early 2020 mainly for three reasons: first, these loans had reached their maturity date; second, certain tax provisions enacted under TCJA rendered the tax structure of some of these loans no longer effective; and, finally, as these loans were being restructured for the reasons stated above, EUSHI's parent, Emera took the opportunity to optimize its intercompany financing transactions by centralizing the intercompany financing activities into one main financing entity owned by EUSHI. As a result, for the projected test year 2021, EUSHI parent capital structure will only consist of common and preferred equity, with no debt as disclosed on MFR C-26.

**Q.** Why did Peoples not include a parent debt adjustment over the last several years?

**A.** In Peoples' last base rate proceeding, in 2008, the capital structure of TECO Energy was used to calculate any parent debt adjustment. As previously mentioned, Peoples' parent TECO Energy has not had debt on its balance sheet for many years and as a result Peoples has not included a parent debt adjustment during that period.

**Q.** When did Emera become the owner of Tampa Electric and Peoples?

**A.** Emera acquired all the outstanding common shares of TECO Energy on July 1, 2016.

**Q.** How much did Emera pay to acquire the stock of TECO Energy?

**A.** The net cash purchase price totaled $6.5 billion USD and the assumption of debt of $4.2 billion USD for a total aggregate purchase price of $10.7 billion USD. The net cash purchase price amount of $6.5 billion USD was paid to the shareholders of TECO Energy stock as of July 1, 2016.

**Q.** Can you provide additional background on how Emera financed the acquisition of TECO Energy?

**A.** Yes. The financing of the $6.5 billion USD purchase price was achieved by issuing a combination of debt and equity in Canada, as well as debt in the U.S. Financing in Canada was achieved via the issuance of convertible debentures ($1.6 billion USD), fixed to floating subordinated notes ($1.2 billion USD), Canadian long term debt ($380.0 million USD), cash on hand and proceeds from the sale of assets. Financing in the U.S. was achieved by the issuance of $3.25 billion USD long-term senior unsecured notes. The total of these sources of cash were accumulated and used to capitalize EUSHI with a combination of common and preferred equity used ultimately to acquire all of the stock of TECO Energy.

**Q.** Is the financing approach used by Emera commonly used by

Canadian companies?

**A.** Yes. Cross border acquisitions are typically achieved with a combination of capital raised in the home country and in the country of the target company. Access to capital markets is critical in acquisition settings and debt financing is commonly used in cross border transactions when Canadian companies acquire U.S. companies as these financing strategies are set up to produce the most efficient structures and to manage foreign exchange risk.

**SUMMARY**

**Q.** Please summarize your prepared direct testimony.

**A.** The ADIT and income tax expense included in the base period and projected test year cost of service are fair and accurate based on the underlying rate base and recoverable expenses included in the cost of service.

The 2021 projected test year MFR income-tax schedules have been presented on a basis consistent with the historical schedules and consistent with other projected information for the test period. Further, the 2021 projected test year MFR income tax amounts have been properly stated in accordance with GAAP and IRC rules. The income tax amounts have also been adjusted for the amount included in Document No. 2 of my exhibit and have been calculated in accordance with the requirements of the Treasury Regulations applicable to projected test periods. Finally, in accordance with Rule 25-14.004 F.A.C., no parent company adjustment has been applied to the 2021 projected test year.

**Q.** Does this conclude your prepared direct testimony?

**A.** Yes, it does.

(Whereupon, prefiled direct testimony of Charlene M. McQuaid was inserted.)

**PEOPLES GAS SYSTEM**
**DOCKET NO. 20200051-GU**
**FILED: 06/08/2020**

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

**PREPARED DIRECT TESTIMONY**

**OF**

**CHARLENE MCQUAID**

**Q.** Please state your name, address, occupation and employer.

**A.** My name is Charlene McQuaid. Please state your name, address, occupation and employer.

**A.** My name is Charlene McQuaid. My business address is 5151 Terminal Road, Halifax, Nova Scotia, Canada. I am employed by Emera Inc., where I am the Vice President, Human Resources & Organizational Development. I am currently fulfilling an acting role as Vice President, Human Resources for Tampa Electric Company ("Tampa Electric") and for Peoples Gas System ("Peoples" or the "Company").

**Q.** Please describe your duties and responsibilities in that position.

**A.** I am responsible for the leadership and strategic direction of the human resources functions for Tampa Electric and Peoples. I also provide support and liaison to Human Resources at New Mexico Gas Company.

**Q.** Please provide a brief outline of your educational background and business experience.

**A.** I received a Bachelor of Science in Occupational Therapy from Dalhousie University in Halifax, Nova Scotia; a Master of Science (Applied) in Occupational Health Science from McGill University in Montreal, Quebec; and a Certificate in Organizational Development Fundamentals from Queen’s University in Kingston, Ontario.

I have been employed by Emera for approximately 10 years where I have worked in a variety of Human Resources, Safety and Communications roles. My most recent executive role was at Emera Maine where I was the Vice President of HR & External Affairs. I was responsible for the HR, Safety and Communications teams and provided strategic leadership in these functions. Prior to Emera I worked primarily in manufacturing and health care, most notably for Bombardier (68,000 team members worldwide) and Maple Leaf Foods (12,500 team members mostly Canadian based).

**INTRODUCTION**

**Q.** What are the purposes of your prepared direct testimony in this proceeding?

**A.** My prepared direct testimony will show that the compensation and benefits expense in the 2021 projected test year is competitive and reasonable. The purposes of my prepared direct testimony are to explain the Company's philosophy towards compensation and benefits, as well as, describe the Company's total compensation.

**Q.** Have you previously filed testimony before the Florida Public Service Commission ("Commission")?

**A.** No. I have not filed testimony with the Florida Public Service Commission; however, I have filed testimony with and been a sworn witness for proceedings at the Maine Public Utilities Commission with the primary focus of my testimony related to total compensation and benefits.

**Q.** Did you prepare any exhibits in support of your prepared direct testimony?

**A.** Yes. Exhibit No. (CM-1) was prepared under my direction and supervision. My Exhibit consists of 3 documents entitled:

| | |
|---|---|
| Document No. 1 | List of Minimum Filing Requirements ("MFR") - Co-sponsored |
| Document No. 2 | Peoples Benefit Package Description |

Document No. 3 Mercer – Average Annual Health Benefits Costs Per Employee for 2011-2019

The information in the MFR schedules listed in Document No. 1 of my exhibit are based on the business records of the company maintained in the ordinary course of business and are true and correct to the best of my information and belief.

**Q.** What is the Company's basic philosophy with respect to its team members?

**A.** At Peoples, our growth and value are driven by our team members, who are focused on meeting the needs of our customers, today and into the future. As our Code of Conduct states, our commitment is to hire and retain skilled team members who are committed to collaboration and innovation. Our team members are ready to lead in a time when our industry is changing rapidly, embracing innovations that will help the Company safely deliver the clean, affordable and reliable energy that our customers count on. We are committed to world-class safety, relentlessly focused on being safe every moment, of every day. We strive to deliver operational excellence in all that we do. And, we work hard to be recognized as trusted, reliable and innovative.

As described in the Company's Code of Conduct, the Company achieves strategic focus to deliver growth by meeting customer demand for cleaner, affordable and reliable energy by focusing on five key principles:

- Safety, health and the environment;
- Customers;
- Integrity;
- Respect and collaboration;
- Excellence.

The Company believes that the principles inherent in its Code of Conduct and Leadership Competencies create an environment that respectfully engages and inspires team members. The Company's Code of Conduct establishes the foundation for team member integrity to ensure we hold ourselves to a high ethical standard. The Company's seven Leadership Competencies creates the basis for team member behavior as they develop as leaders. Our Leadership Competencies are:

1. Speaks Up on Safety, Health, and the Environment;
2. Takes Ownership and Acts with Integrity;
3. Drives Operational Excellence for Customers;
4. Builds Strong Collaborative Relationships;
5. Develops Peoples and Teams;

6. Cultivates Innovation and Embraces Change; and
7. Thinks Strategically and Exercises Sound Judgment.

The Company believes leadership is a mindset and that every team member can be a leader in their work performance. The work environment the Company creates, paired with career opportunities help team members see their future at Peoples. These characteristics combined with a competitive compensation and benefits supports the Company in attracting and retaining strong and skilled talent. The Company believes that customers benefit when Peoples retain, attract, reward and respect skilled and committed team members. The Company believes that taking care of its team members via a competitive health and benefits package contributes to their safety, performance and productivity at work, thus benefiting Peoples' customers.

Peoples' pay for performance model is based on total compensation that aligns its team members and customer interests. An effective compensation program is based on market value, internal equity and affordability for Peoples' customers. Further ensuring adequate portions of compensation is variable or "at risk" is both competitive and promotes focus on overall safety, reliability, organizational performance, and other customer goals.

**Q.** What is the outlook for Peoples' human resource needs in 2020 and 2021?

**A.** Peoples expects its overall team member count and related expenses to grow in 2020 and 2021 as a result of its projected customer growth; enhancements in safety, safety quality assurance and damage prevention; and in response to technology advances. These additions are discussed in Company witnesses Richard F. Wall's and Timothy O'Connor's prepared direct testimonies. The projected O&M impact from adding team members in 2020 and 2021 is shown on MFR G-2 sponsored by Company witness Sean P. Hillary.

Peoples is focused on ensuring it has the right team members, with the right skills in the right roles in order to safely and reliably meet its customers' needs.

**Q.** What are the objectives of the Company's total compensation and benefits programs?

**A.** The Company strives to attract and retain talented people in order to meet Peoples' customer requirements, which is why the Company provides a competitive total compensation and benefits package. The Company's total compensation and benefits programs include: Base salary, short and where applicable, long-term incentive plans, pension/401k, paid time off programs, Employee Common Share Purchase Plan and benefits plans. Peoples strongly believes that having a highly motivated work force results in team members who reflect the values of the Company. Peoples' skilled and experienced team excels in every aspect of the Company's operations. Peoples also believes that such a workforce contributes to the Company's excellent customer service.

**Q.** Are the Company's total compensation and benefits costs reasonable?

**A.** Yes. As noted below in more detail the Company benchmarks its total compensation and benefits costs against applicable markets using relevant utility benchmarks for both compensation and benefits.

**COMPENSATION**

**Q.** What is the Company's compensation philosophy?

**A.** Peoples recognizes that a competitive pay program is a critical component of an team member's total compensation and enables the Company to attract and retain skilled team members. Peoples' considers total direct compensation in evaluating the competitiveness of its pay program, which includes, base salary and variable short-term and long-term incentive pay. Peoples total compensation program is structured to be aligned with the middle of the market. Peoples uses Total Direct Compensation (“TDC”) in understanding the market. TDC references three components of team member compensation being base salary, short term incentive plans (“STIP”) and long-term incentive plans (“LTIP”) and how this compares to market. All three components are important to ensure the company’s team members receive competitive compensation, thus allowing the Company to attract and retain talented people. The Company assess it’s compensation program against the market utilizing data from the U.S. Mercer Benchmark data base and the Willis Tower Watson MMPS Survey. After the 2020 merit process, Peoples’ total compensation was at 99 percent of the middle of the market.

**Q.** Please describe the components of compensation in more detail.

**A.** Base salary is the cash compensation team members regularly receive in their paychecks. All Company team members receive a base salary or hourly wage. Certain job classifications are eligible for overtime and/or shift differential pay. All team members are eligible for STIP, and generally directors and above are eligible for LTIP.

The Company's STIP compensates team members for the achievement of annual Company objectives. The objectives for STIP center around performance in Safety, People, Customer, Asset Management and Financial. The Company's objectives in each of these areas is focused on:

1. Safety: Achieve World Class Safety by developing a culture of safety leadership and a reduction in serious injuries.
2. People: Develop the Company's human capabilities to shape and achieve its strategic vision. The Company does this by building team member commitment, standardizing work processes, and developing team members and leaders.
3. Customer Experience: Provide outstanding Customer Service in ways that results in customer loyalty and dedication by reaching high customer satisfaction levels as measured by multiple key customer service metrics.
4. Asset Management: Realize high operating performance with a continued focus on safety, compliance and strategic growth.
5. Financial: Achieve solid financial objectives and effective cash flow management.

Achieving the STIP objectives is intended to benefit customers, directly and indirectly. The Company has two different types of STIPs. The first STIP objective is for managers and above, called a Balanced Scorecard ("BSC"). The second STIP objective is called Performance Sharing Program ("PSP"), which is for supervisors and below.

The Company's LTIP is meant to be a key senior leadership compensation and retention program. The purpose of the LTIP is to align senior leaders' long-term incentive pay with the corporate and shareholder goals. As stated above, it is an important component of a competitive total compensation program for senior leaders. As with base pay and STIP, LTIP for senior leaders allows Peoples to attract and retain skilled leaders.

**Q.** What are the projected merit increases for 2020 and 2021?

**A.** Merit increases for 2020 and 2021 are projected to be 3 percent each year.

**Q.** What is the Company's projected STIP cost for 2021, as compared to the 2019 historic base year?

**A.** As disussed in Company witness Hillary's prepared direct testimony, in 2019, the net income goal was exceeded resulting in additional incentive compensation to team members. The total 2019 historic base year's short-term incentive compensation expense was approximately $5.0 million. The 2021 projected test year's short-term incentive compensation budget of $4.5 million does not assume that the target goals are exceeded. Therefore, a decrease is assumed from the 2019 historic base year to the 2021 projected test year.

**Q.** What is the Company's projected LTIP cost for the 2021 projected test year as compared to 2019 historic base year?

**A.** As discussed in Company witness Hillary's prepared direct testimony, the LTIP cost in the 2021 projected test year is approximately $1.56 million, as compared to $1.96 million in the 2019 historic base year. The actual 2019 LTIP cost and payout was higher in 2019 due to exceeding the LTIP measurement objectives in 2019. The 2021 budget assumes the LTIP objectives are not exceeded.

**Q.** Describe the Company's annual merit process.

**A.** The Company's annual merit process is designed to provide team members an opportunity to earn an increase in their total direct compensation ("TDC") in order to recognize performance and remain competitive with the market. This merit process is closely tied to the talent management process, which results in an overall team member performance assessment annually. Each year team members establish goals and reaffirm position accountabilities with their performance coach. The team member goals are aligned with the Company's annual objectives, as set out in the Company's STIP programs. The position accountabilities are aligned with the team member's specific role functions. Leadership Competencies are also assessed during the review process. A team member's overall assessment is rated on a five-point scale based on expectations (Significantly Exceeds; Exceeds Many, Fully Meets, Meets Most; Does Not Meet). Team Member's overall performance rating is directly related to the percentage of their merit increase. Following the year-end performance review, the performance coach recommends an appropriate merit adjustment for each non-covered/non-union team member based on performance, TDC compa-ratios and budget. These recommendations are approved by each higher level of leadership, eventually through to the officer level.

**BENEFITS**

**Q.** Describe the Company's benefits package.

**A.** The Company's benefits package is designed to maintain a competitive position within the market in order to attract, retain, and develop competent and qualified team members. These comprehensive benefits include: consumer driven health plans, pharmacy plans, employee family assistance plans, dental and vision plans, flexible benefits plans (Healthcare FSA, Dependent Care FSA and Transportation and Parking FSA), life insurance (basic, supplemental, spousal and child), long-term care insurance, group retirement plans, long-term disability, and retiree medical. Exhibit No. (CM-1) Document 2 shows a more detailed description of these plans.

**Q.** What is the Company's gross benefits cost for the 2021 projected test year as compared to the 2019 historic base year?

**A.** Peoples' total gross benefits cost is projected to be approximately $13.9 million in 2021, as compared to approximately $13.1 million in 2019.

**Q.** How does the gross benefits costs compare with the amounts the Company has included in O&M FERC account 926 Pension and Benefits?

**A.** As stated in Company witness Hillary's prepared direct testimony, Peoples' pension and benefits cost in O&M FERC account 926 is projected to be approximately $10.9 million in 2021 as compared to $10.5 million in 2019. Also noted in Company witness Hillary's prepared direct testimony, a portion of benefits costs are capitalized with labor or are clause recoverable, therefore the amount in FERC account 926 is lower than the gross benefits costs.

**HEALTHCARE BENEFITS**

**Q.** What factors are driving healthcare costs in the U.S.?

**A.** The main drivers of increased medical cost in the U.S. are inflation in unit prices, increases in the utilization of services (primarily due to population aging and the overall deterioration of the health of U.S. citizens), and advances in technology/treatment protocols causing a rise in the frequency and cost level of high cost claimants. The cost drivers for prescription drugs are similar, with specialty drugs representing a disproportionally higher percentage of the cost increases than non-specialty drugs. As with U.S. health care costs, Peoples is noting a substantial increase in projected costs in 2021 aligned with those factors listed above contributing to the Company's increase in cost.

**Q.** What are the Company's healthcare cost for the 2021 projected test year?

**A.** As discussed in Company witness Hillary's direct testimony, the Peoples' 2021 budgeted healthcare costs for active team members, including medical and dental expenses, is $7.8 million as compared to $6.6 million in 2019. The Company received an actuarial estimate from Mercer that supported this cost.

The Company also provides post-retirement healthcare benefits and records expenses based on actuarial calculations, similar to pension expense. The 2021 budget of approximately $882,000 was based on the Mercer's actuarial projection. The 2019 post-retirement expense was approximately $843,000.

**Q.** How does the Company evaluate the design and cost of it's health care programs?

The Company retained Mercer Health Benefits who uses underwriting techniques, based on actuarial guidelines, to project the future plans costs for the self-funded plans. The key factor in projecting future results is the prior experience of a group, especially when the group consists of a large population. The process of forecasting past claims experience into the future considers plan designs, member demographics, trends and group credibility. These processes are widely accepted within the insurance market as the standard to establishing budget and premium levels that are appropriate to cover future risks.

**Q.** How does the Company’s healthcare plan compare to industry standards?

**A.** Document No. 3 of my exhibit entitled Mercer – Average annual health benefits costs per employee for 2011-2019 demonstrates that Peoples’ costs during this period were lower than industry experience, except in 2018, where it was aligned with the benchmark. According to Blue Cross Blue Shield (“BCBS”), in 2019 Peoples was at or slightly below health benchmarks overall but the factors that push the Company’s costs upward are, high cost claims, inpatient services and specialty drugs. The benchmark consists of BCBS book of business for National Alliance Platform that includes approximately 1.5 million lives.

**Q.** What specific initiatives has Peoples pursued to ensure its healthcare costs are reasonable?

**A.** In partnerships with industry experts such as Mercer, BCBS and others the Company has put the following initiatives in place in order to ensure its healthcare costs are reasonable:

1. Implemented a pricing strategy to encourage cost-effective plan selections;
2. Reviewed and increased monthly team member contributions annually;
3. Promoted team member and retiree awareness and education around healthcare consumerism;
4. Implemented Personal Care Connections, which is a comprehensive, high touch, disease management program, including health coaching, to facilitate the effective medical treatment of plan participants with specific diseases that, if not properly managed, can generate expensive claim costs;
5. Implemented “Rally”, a digital health platform which promotes overall health and wellness and offers rewards for meeting wellness goals;
6. Conducted vendor analyses and determined moving to Blue Cross Blue Shield from Aetna would result in cost containment from network discounts, network breadth, premium holidays, and implementation/wellness credits;
7. Performed a prescription coverage collective financial review, confirming current vendor offered the most competitive pricing;
8. Restructured prescription program to require 90-day fills by using retail Smart90 pharmacy or home delivery for long-term maintenance medications;

9. Implemented a Telehealth benefit for medical and dermatology, which is less expensive than the average office visits alternative;
10. Negotiated a Medicare Advantage renewal decrease with no plan changes; this resulted in a significant annual savings for both the Company and plan participants;
11. Procured stop loss insurance coverage for 2020 to limit annual medical claim amounts to $300,000 annually per covered plan member; and
12. Implemented the Peoples' Industrial Athlete program that provides overall wellness and injury prevention initiatives through partnership with an external health professional group. This effort has reduced musculoskeletal injuries and enhanced wellness across Peoples.

**PENSION AND RETIREMENT SAVINGS BENEFITS**

**Q.** Please describe the pension and retirement savings plans and how they compare to industry standards?

**A.** Peoples' team members participate in the following retirement plans:

1. TECO Energy Group Retirement Plan (a qualified defined benefit pension plan)
2. TECO Energy Group Retirement Savings Plan (a qualified

defined contribution 401(k) plan)

3. TECO Energy Group Benefit Restoration Plan (a non-qualified defined benefit pension plan)

4. TECO Energy Group Postretirement Health and Welfare Plan (a retiree medical plan)

The Company uses an independent consultant, Mercer, to evaluate the competitive positioning of the qualified pension and savings plans. Mercer's database includes detailed plan data for over 1,100 companies, including the Fortune 500 as well as smaller companies with revenues ranging from $5.0 million to $1.5 billion and is compiled solely from publicly available information. Of the 58 utilities in the database, 28 percent provide a defined benefit ("DB") plan to new hires while 72 percent provide only a defined contribution ("DC") plan. Of the plans that are offered today, the value of the combined DB and DC program, 9.9 percent of pay, is at the 50th percentile of all 58 companies in the database.

**Q.** What is the Company's retirement expense for pension and retirement savings in the 2021 projected test year?

**A.** The total retirement expense for pension in the 2021 projected test year is $2.0 million. This includes $1.7 million for the Retirement Plan, $127,000 for the Supplemental Executive

Retirement Plan and $133,000 for the Restoration Plan. These projected pension expenses are included in FERC account 926 and MFR G-2.

**Q.** Is it common to use an independent actuarial firm to compute pension and post-retirement benefit costs?

**A.** Yes. Based on the benefits provided and employee demographics, an actuary for a defined benefit plan estimates the value of employer obligations. The calculation of liabilities considers a number of complex variables including expected future compensation increases, asset returns, rates of retirement, disability, death and other reasons for termination. Actuaries use historical data and future expectations to make assumptions for these variables. Actuaries for defined benefit plans also ensure the employer is following laws and regulations regarding pension plans. This includes the timely certification of minimum contributions and the funded status under The Employee Retirement Income Security Act of 1974 (ERISA). As there are extensive variables and regulations to consider, it is common and often necessary, for companies to engage actuarial firms to compute pension and post-retirement benefit costs.

**Q.** Do the actuarial assumptions and methods provide a reasonable basis for determining the level of pension costs to be included in the Company’s operating cost?

**A.** Yes. The actuarial assumptions and methods used for the pension valuation are reasonable both individually and in the aggregate.

**SUMMARY**

**Q.** Please summarize your prepared direct testimony.

**A.** Peoples’ total compensation package is reasonable and benefits customers by ensuring we are able to attract and retain skilled, talented and customer-focused team members that safely deliver reliable service for our customers. Peoples’ pay program is structured to pay at the middle of the marketplace and is based on total direct compensation. Additionally, the Company’s benefits and retirement programs are reasonable and competitive and allow the Company to retain and attract high quality team members who are committed to safely and reliably providing excellent, high quality natural gas sevice to Peoples’ customers.

**Q.** Does this conclude your prepared direct testimony?

**A.** Yes.

(Whereupon, prefiled direct testimony of Lorraine L. Cifuentes was inserted.)

**PEOPLES GAS SYSTEM**
**DOCKET NO. 20200051-GU**
**FILED: 06/08/2020**

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

**PREPARED DIRECT TESTIMONY**

**OF**

**LORRAINE L. CIFUENTES**

**Q.** Please state your name, address, occupation and employer.

**A.** My name is Lorraine L. Cifuentes. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed by Tampa Electric Company ("Tampa Electric") as the Director of Load Research and Forecasting.

**Q.** Please describe your duties and responsibilities in that position.

**A.** As an employee of Tampa Electric, I provide load research and forecasting services which are included in shared services that Tampa Electric provides to U.S. affiliates. My present responsibilities include leading the development of the customer, energy consumption and base revenue projections for both Peoples Gas System ("Peoples" or the "Company") and Tampa Electric, as well as, management of Tampa Electric's load research program and other related activities.

**Q.** Please provide a brief outline of your educational background and business experience.

**A.** In 1986, I received a Bachelor of Science degree in Management Information Systems from the University of South Florida. In 1992, I received a Master of Business Administration degree from the University of Tampa.

In October 1987, I joined Tampa Electric as a Generation Planning Technician, and I have held various positions within the areas of Generation Planning, Load Forecasting and Load Research. In October 2002, I was promoted to Manager, Load Research and Forecasting. In November 2018, I was promoted to Director, Load Research and Forecasting.

**Q.** What are the purposes of your prepared direct testimony in this proceeding?

**A.** The purposes of my prepared direct testimony are to describe Peoples' forecasting process, describe the methodologies and assumptions and present the customer, therm consumption and base revenue forecasts for the residential rate classes (which specifically include the RS1-3, RGS1-3 and RS-SG rates) and the small commercial rate classes (which specifically include the SGS, GS1-GS3 rates) used in Peoples' 2021 projected test year forecast that supports its request for a base rate increase.

**Q.** Did you prepare any exhibits in support of your prepared direct testimony?

**A.** Yes. Exhibit No. (LLC-1) was prepared under my direction and supervision. My Exhibit consists of seven Documents, entitled:

| | |
|---|---|
| Document No. 1 | List of Minimum Filing Requirement Schedules ("MFRs") - Sponsored and Co-Sponsored by Lorraine L. Cifuentes |
| Document No. 2 | Historical and Forecasted Residential and Small Commercial Customers |
| Document No. 3 | Historical and Forecasted Residential and Small Commercial Average Usage |
| Document No. 4 | Historical and Forecasted Residential and Small Commercial Therms |
| Document No. 5 | Historical and Forecasted Service Line Capital Expenditures |
| Document No. 6 | Historical and Forecasted Heating and Cooling Degree-Days |
| Document No. 7 | 2017-2021 Total Customers, Therms and Base Revenues |

The information in the MFR schedules listed in Document No. 1 of my exhibit are based on the business records of the company maintained in the ordinary course of business and are true and correct to the best of my information and belief.

**SUMMARY OF FORECAST RESULTS**

**Q.** Please summarize your forecast results.

**A.** The Company expects residential customers to grow by 7.0 percent (25,336 customers)from 2019 to 2021. The Company expects residential therm sales for the same period to increase by 13 percent, the higher increase a result of the milder weather in 2019.

The Company expects small commercial customer growth over the next two years (2019 to 2021) to be 4.7 percent (1,675 customers). The Company expects small commercial rate therm sales over the same period to increase by 6.6 percent. See Exhibit No. (LLC-1), Document Nos. 2 through 4.

In regard to large commercial and industrial customers, the Company has specifically forecasted customer additions and usage at the customer level. The inputs received in that process are described later in my prepared direct testimony.

**Q.** Please explain the Company’s experience with customer growth since the last rate proceeding that was filed in 2008.

**A.** The last base rate proceeding was during a period of unusual uncertainty and economic disruption due to the “Great Recession”. Residential customer growth was impacted the most by this downturn. Residential customer growth was flat to declining during 2009 and 2010, compared to four and five percent customer growth prior to this. In 2011, the Company started experiencing growth again but below one percent a year. In 2012, growth began to exceed one percent a year. By 2015, residential growth was exceeding two percent a year and in 2018 exceeded three percent a year and is projected to remain above three percent a year through to the 2021 projected test year.

In short, customer growth and consumption have changed from historical levels and the load growth the Company expects will be higher than the historical averages.

The process Peoples uses to prepare its forecasts and the steps it has taken to ensure the forecast is reasonable are discussed below in my direct testimony.

**PEOPLES’ FORECASTING PROCESS**

**Q.** Please describe how Peoples' customer and therm forecasts are developed.

**A.** Peoples' forecast process is a joint effort between Peoples' and Tampa Electric's Load Forecasting team, as well as many other behind the scenes participants.

The Company has 14 service areas throughout Florida. Each of these service areas are forecasted individually and then aggregated to get total company level forecasts. The forecast process has two tracks of work which go on simultaneously. One track is specific to the residential and small commercial rate classes and the second track is for the higher usage commercial and industrial customers which are forecasted individually.

<u>TRACK ONE</u>: This track is based on regression modeling techniques and is done by Tampa Electric's Load Forecasting team. Regression models estimate the mathematical relationships between two or more variables (e.g. dependent variable and independent variables) and applies this relationship to predict future values of the dependent variable. This process is used to forecast Residential and Small Commercial rate class customers and therm consumption. The Residential class consists of Residential Service (RS)

rates 1-3 and Residential General Service (RGS) 1-3 rates. The Small Commercial class consists of Small General Service (SGS) and General Service (GS) 1-3 rates.

The first step in the forecast process is to obtain a clear understanding of the data to be forecasted (the dependent variable) and the variables that have an impact on the data (independent variables). The primary areas reviewed include recent trends in customer growth, usage patterns and weather for each service area. Customer (bill) counts and consumption (therms) data for each service area are collected from the Company's billing system. The billing data and weather, in terms of degree-days, for each service area is reviewed to determine if any abnormal events (e.g. the hurricane that impacted Panama City in 2018) occurred that affected customers and/or therm consumption. Any data anomalies are investigated and action plans are developed to appropriately address them during the modeling process.

The second step is a detailed analysis of the major assumptions used in the forecast process. Each assumption is reviewed by the Load Forecasting department for reasonableness and consistency with recent trends.

At this point in the process, the data and assumptions are ready to import into Itron's MetrixND forecasting software, an industry accepted, advanced statistics program for regression analysis and forecasting. Peoples' retail customers and therm forecasts are the result of a 56 regression equation model.

The customer model is a twenty-eight equation model made up of 14 service area regression models for the residential class and 14 service area regression models for the small commercial class. Typically, the number of customers over the past 10 years is the dependent variable. The primary independent variables, also known as explanatory variables, are capital expenditures associated with new service lines, and/or trend variables. In addition, binary variables (as defined below) are used to adjust for anomalies or seasonality.

The therms-per-customer model is also a twenty-eight equation model made up of 14 service area residential and 14 service area small commercial regression models. These average use (Therm-per-Customer) regressions are developed similarly to the customer models with the primary explanatory variables being heating and/or cooling degree-days which explain the historical monthly weather variability.

Next, the model coefficients are estimated for the 56 regression equations and the common statistical measures of validity and reasonableness are analyzed and evaluated.

To derive the residential and small commercial total therm forecasts for each service area, the 28 customer model results and the 28 therm-per-customer model results are multiplied, resulting in total therms.

TRACK TWO: This track is a joint effort by Peoples' Business Development and Accounting departments. The forecasts developed in track two do not require regression techniques. Since the number of customers are not very large, these forecasts are developed on an individual customer basis. The rates classes being forecasted are the larger commercial and industrial rates (GS4, GS5, WHS, SIS, IS and ISLV, Special Contracts and Off-System Sales). These forecasts are based on an analysis of recent customer usage trends and input from customers when necessary. The Commercial Standy-by Generator (CSG), Natural Gas Vehicle Service (NGVS) and Commercial Street Light Service (CSLS) rates are forecasted based on recent historical usage. In addition, new customers, therms and revenue projections for known or expected projects are layered in the forecast.

**Q.** Which rate classes in this process are you responsible for?

**A.** I am responsible for the rate classes in track one of this process. The residential rates and the small commercial rates are listed above.

**Q.** Does Peoples assess the appropriateness and reasonableness of these forecasting models?

**A.** Yes. A variety of measures and criteria are used to ensure the reasonableness of the model equations and results. Measures of statistical fit and significance are reviewed for each model. Some of the measures reviewed include R-squared, T-Statistic, Mean Absolute Percent Error (MAPE) and Durbin-Watson Statistic. After reviewing these statistics, the models were found to be theoretically sound with excellent model statistics indicating that the predictability of the model is sound.

**Q.** Please explain why capital expenditures for new service lines are used as the primary explanatory variable in the customer models?

**A.** Prior to 2018, Peoples used population growth as the primary explanatory variable in predicting residential customer growth. In 2016, spending on new service lines began to increase over historical levels and customer growth also began getting stronger. At that time, it was noted that capital spending on service lines had a stronger correlation than population to Peoples growth in residential customers. This correlation makes sense given that the installation of the service line is often the final step before a customer comes on line. Capital expenditures for new service lines were used as the primary explanatory variable in the customer models because it has the most immediate revenue producing impact since it is a direct link to when a new customer is being added to the system. The strong correlation that exists between customer growth and service line spending is evident in the model statistics, this supports that using capital expenditures for new service lines as the explanatory variable in the customer models is appropriate and reasonable.

**Q.** Where are the service line capital expenditure assumptions inputs developed and how are they used in the revenue forecast?

**A.** The projected annual service line capital expenditures are developed and provided to the Load Forecasting department by Peoples Business Planning department. Next, the Load

Forecasting department accumulates capital expenditures, in real terms, over a period of time. Since the Company’s regression models forecast total customers versus annual incremental customers, the explanatory variable must also represent total expenditures spent through time versus just the annual incremental expenditure. See my Exhibit No. (LLC-1), Document No. 5 for historical and projected Capital Expenditures for Service Lines.

**Q.** How were the degree-day assumptions used in the therm-per-customer models developed?

**A.** Since future weather is unknown, a normalized, or average, weather pattern is assumed and used over the forecast horizon. Degree-day assumptions are based on average weather patterns over the past 20 years, excluding outliers and anomalies. Outliers and anomalies are statistically identified as any month where the heating or cooling degree-day value is above or below two standard deviations from the mean. Each service area’s degree-days are analyzed to develop its normal weather assumptions. AccuWeather is the source for each service area’s daily temperatures that are used to calculate degree-days. See my Exhibit No. (LLC-1), Document No. 6 for weighted average heating and cooling degree-days.

**Q.** Please explain what trend and binary variables are.

**A.** A trend variable is a time-trend which increments by 1 through time. It is used to capture changes or trends that are not explained by the other independent variables. For a service area that does not correlate well with the capital expenditure variable, a trend variable will be substituted. It can also be used in addition to the capital expenditure variable.

Binary variables are used to indicate the absence or presence of some effect that may shift the outcome, they simply take on a value of 0 or 1. In the customer models, binary variables are used to get a different coefficient for each month to capture seasonality that other variables do not capture. For example, customer counts fluctuate throughout the year due to temporary residency related to vacation homes or seasonal jobs, the binary variables capture these trends. In addition, a binary variable is used to isolate one-time events such as hurricane outages so that the event does not impact the outcome of the other explanatory variables. Binary variables are also used when there is a structural change in the data series being forecasted. For example, if the boundaries of two adjacent service area are redefined, the drop in customer counts for one service area and increase in customers for the other service area can be captured with a binary variable

("0" before the change and "1" after the change). This variable captures the one-time shift without impacting the other explanatory variables.

**Q.** Does Peoples assess the reasonableness of these base assumptions?

**A.** Yes. The base case assumptions of capital expenditures for service lines and the assumptions of degree-days have been evaluated for reasonableness by reviewing the statistical significance of each assumption. In addition, backcasting of each customer model was done to assess the reasonableness of the assumption's and the models' ability to predict the past two years. The models and assumptions provided reasonable predictions of the past two years.

**PEOPLES'S FORECASTED TOTAL GROWTH**

**Q.** What is Peoples' 12 month average customer base in 2019?

**A.** Peoples' 12 month average in 2019 for customers is 398,492.

**Q.** What is Peoples' projected total customer growth over 2020 and 2021?

**A.** Peoples is projecting an increase of 27,016 net new customers over the next two years (2019 to 2021). See my Exhibit No. (LLC-1), Document No. 7 for projected number of customers by class.

**Q.** What is Peoples' total therm sales forecast for the 2021 projected test year?

**A.** The Company expects total therm sales to be approximately 2,282,200,000 in the 2021 projected test year. Forecasted total therm sales are shown in my Exhibit No. (LLC-1), Document No. 7.

**Q.** Does Peoples' make adjustments to the regression models' forecasts?

**A.** Yes, customers and therms are exogenously added for new residential developments in Daytona and Panama City as well as for residential and commercial gas heat pumps. In addition, the large commercial and industrial forecasts incorporate growth for known or expected projects. These adjustments are provided to the Load Forecasting department by the Business Development department in Peoples.

**Q.** Are the forecasts of customers and therm sales appropriate and reasonable?

**A.** Yes. The customer and therm sales forecasts are based on the most recently available data at the time the forecasts were developed, and each assumption was reviewed for reasonableness. The forecasting methods used to develop the forecasts are theoretically and statistically sound. The average annual growth rates for customers and therms are in line with recent growth trends and consistent with model assumptions. In addition, the average model error over the past five years for the residential customer forecast is 0.1 percent (319 customers) and for the small commercial customer forecast it is 1.2 percent (429 customers). Based on the above, the forecasts are appropriate and reasonable.

**PEOPLES' BASE REVENUE FORECASTING PROCESS**

**Q.** How are the base revenue forecasts developed?

**A.** The base revenues are developed in Microsoft Excel spreadsheets. Each service area has its own model and the 14 service areas are aggregated to arrive at the total base revenue projections.

The inputs to this model are:

1. The most recent approved tariff rate schedules of customer charges and per-therm distribution charges;

2. Forecasted customers from the regression models;

3. Forecasted therms-per-customer from the regression models;
4. Forecasted customers and therms from non-regression techniques;
5. Exogenous forecast adjustments for growth not accounted for in the regression models; and
6. Billing Determinate allocation factors.

The revenue model inputs one through five above have previously been discussed in my prepared direct testimony. The sixth input, the billing determinate factors, represent the percentage of customers and therms to allocate to each rate schedules.

The Residential class has 10 rates schedules:

- Residential Service (RS) 1-3;
- Residential General Service (RGS) 1-3;
- Natural Choice Transportation Residential General Service (GST) 1-3; and
- Residential Standby Generator (RS-SG).

The Small Commercial class has eight rates schedules:

- Small General Service (SGS);
- Natural Choice Transportation Small General Service (SGTS);
- General Service (GS) 1-3; and
- Natural Choice Transportation General Service (GST) 1-3.

The larger commercial and industrial classes are forecasted at the customer level so there is no need to apply allocation factors.

Once the customers and therm consumption are allocated to all the rate schedules, the customer charges and distribution per-therm charges are applied and totaled to arrive at base revenues.

**Q.** How are billing determinate allocation factors determined for each service area?

**A.** The first step is to calculate the historical factors (e.g. the percentage of total residential class customers that are in the RS1 rate schedule, RS2, etc.).

Next, the trend in these percentages are analyzed for each rate schedule in each service area. The trend is extended into the future based on average change rates. For example, if the historical trend is declining percentages, the projected year will continue the decline based on the historical rate of change.

**PEOPLES' FORECASTED BASE REVENUES**

**Q.** What are base revenues expected to increase by in 2021 projected test year, based on current rates?

**A.** Based on current 2019 rates, base revenues are expected to increase by 2.8 percent or $6,401,475 in the 2021 projected test year. See Exhibit No. (LLC-1), Document No. 7 for base revenues by sector.

**Q.** Does Peoples conclude that the forecasts of base revenues are appropriate and reasonable?

**A.** Yes, based on the reasonableness of the customer and therm forecasts discussed in my prepared direct testimony, the reasonableness of the individual billing determinates and the accurate application of tariff rates in the revenue model, the forecasts of base revenues in the 2021 projected test year are appropriate and reasonable.

**SUMMARY**

**Q.** Please summarize your prepared direct testimony.

**A.** Peoples' service area will continue to grow at a steady pace over the forecast horizon. The Company expects a net increase in customers of approximately 13,000 and therm sales of approximately 2,282,200,000 in the 2021 projected test year. The methods used for developing the customer and therm sales forecasts presented in my prepared direct testimony represent industry accepted and statistically sound practices and are based on appropriate and reasonable assumptions.

**Q.** Does this conclude your prepared direct testimony?

**A.** Yes, it does.

(Whereupon, prefiled direct testimony of Daniel P. Yardley was inserted.)

**DOCKET NO. 20200051-GU**
**FILED: 06/08/2020**

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

**PREPARED DIRECT TESTIMONY**

**OF**

**DANIEL P. YARDLEY**

**ON BEHALF OF PEOPLES GAS SYSTEM**

## I. INTRODUCTION

**Q.** Please state your name, affiliation and business address.

**A.** My name is Daniel P. Yardley. I am Principal, Yardley & Associates and my business address is 2409 Providence Hills Drive, Matthews, NC 28105.

**Q.** On whose behalf are you testifying?

**A.** I am testifying on behalf of Peoples Gas System ("Peoples" or "the Company").

**Q.** Please provide a brief outline of your professional and educational background.

**A.** For the last 30 years I have been employed as a consultant to the natural gas industry. During this period, I have directed or participated in numerous consulting assignments on behalf of local distribution companies ("LDCs"). I have extensive experience analyzing and developing LDC and gas pipeline cost allocation studies, rate design studies, and in other tariff matters, including the development of revenue adjustment and cost recovery mechanisms. I have also performed gas supply planning analyses and financial evaluation analyses on behalf of LDCs. I received a Bachelor of Science Degree in Electrical Engineering from the Massachusetts Institute of Technology in 1988.

**Q.** Have you previously testified before the Florida Public Service Commission (the "Commission")?

**A.** Yes. I testified in Peoples' prior rate case before the Commission in Docket No. 20080318-GU. I have also testified on numerous occasions before other state utility commissions, the Federal Energy Regulatory Commission, and the Canada Energy Regulator on a variety of rate and regulatory topics. The subject matters addressed in these proceedings include cost allocation, service design, rate design, revenue decoupling, cost recovery mechanisms and tariff design.

**Q.** What is the purpose of your testimony in this proceeding?

**A.** The primary purpose of my prepared direct testimony is to develop and support Peoples' proposed rate design applicable to the Company's firm and interruptible distribution services. I will highlight important industry developments since Peoples' last base rate case in 2008 and explain the implications for the rate design that is appropriate to implement in this proceeding. The rates that I propose fairly apportion the Company's revenue requirement among customer classes, to be recovered through appropriate rate components applicable to each class. The non-uniform increases to various rates and charges reflect the results of the Company's allocated cost of service study ("ACOSS"), which I am supporting through my prepared direct testimony.

**Q.** Have you prepared an Exhibit to be introduced in this proceeding?

**A.** Yes. My Exhibit No. (DPY-1) consists of 6 Documents were prepared by me or under my supervision, entitled:

| | |
|---|---|
| Document No. 1 | List of Minimum Filing Requirements Sponsored; |
| Document No. 2 | Cast Iron / Bare Steel Rider ("CI/BSR") Revenues Roll-In; |
| Document No. 3 | Allocation of Proposed Revenue Requirements to Base Rates; |
| Document No. 4 | Existing and Proposed Base Rates and |

| | |
|---|---|
| | Revenues; |
| Document No. 5 | Rate of Return by Class; and |
| Document No. 6 | Comparison Of Existing Customer Charges And Customer-Related Costs By Class |

**Q.** How is your prepared direct testimony organized?

**A.** My prepared direct testimony is organized into two sections following this introduction. Section II provides policy background related to current trends in rate design. Section III details Peoples' rate design goals and the development of the proposed base rates.

**RATE DESIGN POLICY BACKGROUND**

**Q.** How does rate design affect the achievement of energy policy objectives?

**A.** From a public policy perspective, rate design is a critically important tool for achieving specific energy policy goals that influence the quality of life for Florida's citizens and the State's competitive position. Policy goals affected by rate design include end-use fuel mix, energy efficiency and the resulting environmental and cost impacts of energy consumption. Therefore, the form of a utility's rate structure is an important building block that can contribute to achieving important energy policy goals.

The nexus between rate design and energy policy objectives continues to receive attention throughout the U.S., due in large part to the prevalence of usage-based rate designs. Usage-based rate designs recover a substantial portion of LDC fixed-cost revenue requirements through volumetric charges applied to the amount of natural gas consumed by customers. The inherent operating incentives under this form of rate structure are for the LDC to add new customers and to promote increased consumption by its existing customers.

While adding new customers is beneficial and consistent with energy policy goal of reducing oil heating use, the incentive to increase consumption by current customers is at odds with other public policy goals that favor energy conservation and reductions in customer energy bills. LDCs such as Peoples are promoting increased energy efficiency to their customers. Rate design is a necessary element that enables LDCs to fully embrace the energy efficiency imperative while also meeting fiduciary responsibilities to shareholders, regulators and customers alike.

**Q.** Why are usage-based rate designs prevalent among LDCs?

**A.** The traditional approach to rate design found in many jurisdictions today reflects historical industry drivers and market conditions. The U.S. natural gas delivery system underwent a period of broad expansion that lasted for decades following World War II. This expansion, enabled by advances in metallurgical technologies and welding techniques, brought the benefits of reliable, affordable and clean-burning natural gas to millions of households and businesses throughout the U.S., including those in Florida. Public policy promoted the expansion of natural gas infrastructure and additional penetration of natural gas into more homes and for additional end-uses. This public policy was reflected in throughput-based rate designs as expanding systems and growing loads allowed an LDC’s fixed costs to be spread over greater levels of billing units, lowering average costs to consumers. Traditional usage-based rate designs were appropriate under the circumstances in which they were developed. However, the present imperative to promote increased energy efficiency in order to lower customer bills and reduce carbon emissions calls for a reordering of priorities.

**Q.** How would you characterize Peoples’ existing rate design?

**A.** Base rates are intended to recover a utility’s cost of service, excluding purchased gas and other tracked costs. The costs recovered through base rates are primarily fixed costs. Peoples' rate design reflects a throughput-based approach, however, important changes implemented in Peoples' previous rate case reduced the magnitude of the resulting throughput incentive. A throughput-based rate design recovers a substantial portion of an LDC's fixed-cost revenue requirements through volumetric charges applied to the amount of natural gas consumed by customers. While the rates for customers include a combination of fixed monthly charges and throughput-based or variable charges, a significant proportion of base rate revenues are derived from the variable charge components and are directly linked to customer usage patterns.

In Peoples' previous rate case, the Commission approved a change to the Company's residential rate design that provided for distinct monthly customer charges based upon a customer's annual load. This provided for a significant reduction in the throughput incentive for residential customers as approximately 77 percent of fixed costs are recovered through fixed charges.

**Q.** Is Peoples proposing to implement a rate design approach that fully eliminates the throughput incentive underlying its existing base rates?

**A.** No, not at this time. Nevertheless, the Company is proposing a rate design that maintains the existing proportion of residential fixed costs that are recovered through fixed charges. At the same time, the proposed rate design moderately increases the proportion of commercial fixed costs that are recovered through fixed charges. The Company believes that gradual progress toward reducing the throughput incentive is an important outcome of its rate design proposal in this proceeding.

**PEOPLES' RATE DESIGN**

**Q.** Please describe the specific rate design goals for Peoples that guided the development of the rate design you are recommending.

**A.** The overall rate design approach I recommend seeks to achieve the following six traditional regulatory goals for rate design and cost recovery:

(1)Fairness – Fairness is accomplished through pricing services based on the underlying cost. Fairness is important in many respects including between the Company and its customers, across the classes served by Peoples, and among customers taking service under a common service classification.

(2)Not Discriminatory – Avoiding undue discrimination requires rates that do not grant an unreasonable preference or subject an unreasonable disadvantage to any customer or group of customers.

(3)Rate Moderation – Moderation allows for the implementation of rate design changes over time to ensure that customers are not exposed to dramatic price changes all at once.

(4)Revenue Stability – Revenue stability means that Peoples' base rate revenues are more predictable in view of future uncertainties. As customer usage patterns have become less certain, improved revenue stability through rate design takes on greater importance as a way of mitigating the increased risks to customers and the Company associated with such unpredictable consumption patterns.

(5)Energy Efficiency – Establishing a rate design that is consistent with public policy promoting reduced energy consumption benefits customers and the environment.

6)Simplicity – Simplicity means a rate structure that is both understandable and straightforward to administer.

At times, these individual goals compete with one another and must be balanced to achieve an appropriate set of rates and tariff provisions to recover the Company's cost of service.

**Q.** Please describe Peoples' existing rate schedules.

**A.** Peoples' existing rate schedules are segregated by sector, nature of service (firm or interruptible) and by customer size. Firm service is primarily provided under one Residential Service ("RS") and six General Service ("GS") rate schedules. The RS class has separate billing classes based on annual consumption. These are RS-1 for residential customers with annual consumption up to 99 therms, RS-2 for residential customers with annual consumption between 100 and 249 therms and RS-3 for residential customers with annual consumption between 250 and 1,999 annual therms. The RS class has a separate billing class for Residential Gas Heat Pump Service ("RS-GHP") as well.

The six GS rate schedules are consumption -based and include Small General Service ("SGS") for customers up to 1,999 annual therms, GS-1 for customers from 2,000 through 9,999 annual therms, GS-2 for customers from 10,000 through 49,999 annual therms, GS-3 for customers from 50,000 through 249,999 annual therms, GS-4 for customers from 250,000 through 499,999 annual therms, and GS-5 for customers above 500,000 annual therms.

A limited number of customers take firm service under one of the Company's end-use-specific rate schedules. These include Commercial Street Lighting Service ("CSLS"), and Natural Gas Vehicle Service ("NGVS"), Residential Standby Generator Service ("RS-SG"), Commercial Standby Generator Service ("CS-SG"), Commercial Gas Heat Pump Service ("CS-GHP"), and Wholesale Service ("WHS").

Peoples also provides interruptible service under three size-based rate schedules – Small Interruptible Service ("SIS"), Interruptible Service ("IS") and Interruptible Service – Large Volume ("ISLV"). Lastly, in some cases, customers taking interruptible service that can either bypass or have alternative fuel sources take service with Peoples under the Contract Interruptible Service ("CIS") rate schedule that governs the pricing and other terms of the service they receive.

**Q.** What rates and charges are incorporated into the RS and GS rate schedules?

**A.** The existing rate design for all of the RS and GS rate schedules is similar and includes two types of base rate charges intended to recover Peoples' non-gas revenue requirements. The RS base rates consist of three size based fixed monthly customer charges and a $0.25465 per therm variable distribution charge. The monthly customer charges are $11.40 for RS-1 customers, $14.25 for RS-2 customers, and $19.01 for RS-3 customers. RS customer charges are applied per customer per month and distribution charges are applied to each customer's monthly therm usage. Under this rate structure, all residential customers pay a minimum amount to Peoples, regardless of their monthly usage. The per-therm distribution charge results in customers paying lower amounts as their consumption decreases. The distribution charge is considered a variable charge because all of the associated revenues are linked to customer usage or throughput.

The existing rate design for GS customers is the same structure as that for residential customers. The existing monthly customer charges range from a low of $23.76 for SGS customers up to $285.09 for GS-5 customers. The per-therm distribution rate is $0.32206 for SGS customers and decreases to $0.10758 for GS-5 customers. Although Peoples' rate structure employs both fixed and variable charges, the majority of firm base revenues are recovered through the variable per-therm charges. Projected 2021 base revenues at existing rates reflect approximately 60 percent of total firm base revenue was attributable to variable charges.

**Q.** Do the remaining rate schedules employ the same type of rate design?

**A.** The majority of the other rate schedules also utilize a combination of monthly customer charges and per-therm distribution charges. Specifically, the CSLS, NGVS, RS-GHP, CS-GHP, WHS, SIS, IS and ISLV rate schedules employ this type of rate structure with varying levels of customer and distribution charges that are intended to reflect the costs incurred to provide service.

The standby generator-only services, RS-SG and CS-SG represent an exception to the typical rate structure. The services were developed in response to customer needs to back up their electric service during hurricane-induced or other electric service outages. Standby generator-only customers do not utilize natural gas as their primary fuel for any end-use. As a result, it is typical for these customers to have zero monthly usage. The existing rate structure for standby generator-only customers reflects a higher customer charge and an initial block of use that includes no per-therm charge. The level of the customer charge and the size of the initial block were derived to yield revenue for an average residential or SGS customer based on the Company’s last base rate proceeding in 2008.

**Q.** Please describe Peoples' CI/BSR.

**A.** In 2012, the Commission approved a rate rider mechanism to recover the costs of accelerated replacement of cast iron and bare steel distribution pipe through a rate surcharge. The revenue requirement associated with eligible replacement activity is calculated each year and reflected in a rate surcharge applied to customer usage. The CI/BSR surcharge for each rate class is based upon the proportion of allocated investment in mains and services in the prior rate case and the projected throughput for the annual recovery period. The Company's CI/BSR is similar to accelerated replacement recovery riders approved for other LDCs in the U.S. In 2016, the Commission approved a change to the CI/BSR that provided for the recovery of investments in replacement of certain categories of problematic plastic pipe through the Rider.

**Q.** Are there separate charges for gas supply?

**A.** Yes. Sales customers that purchase their gas supply from Peoples pay a volumetric Purchased Gas Adjustment ("PGA") rate for gas supply. Sales customers include residential customers with volumetric use up to 1,999 annual therms and GS customers that elect to continue purchasing their gas supply from Peoples. The PGA rate recovers the costs of purchased gas and upstream pipeline capacity and storage resources necessary to ensure firm delivery to customers throughout the year and is adjusted periodically to track changes in Peoples' delivered cost of gas supply. The PGA rate includes an over or under-recovery component (the true-up) that carries forward any difference between gas costs and PGA revenues for recovery or refund in a future period.

**Q.** Do customers have the option of purchasing their gas supply from a third-party seller?

**A.** Yes. Residential customers above 2,000 annual therms and all commercial and industrial customers may elect transportation-only service from Peoples and pay Peoples to deliver gas the customers have purchased from a third-party marketer. The gas price for a firm transportation customer is negotiated in a competitive marketplace between the customer and the marketers. All transportation customers are subject to the additional terms of either the Natural Choice Transportation Service Rider ("NCTS") or the Individual Transportation Service Rider ("ITS"), which govern the relationship among customers, Peoples and marketers including all pool administration functions. Transportation customers also have the option of returning to sales service at any point in the future, subject to certain notice requirements.

**Q.** How does the Company's current rate design compare with the rate designs of other LDCs?

**A.** Peoples' base rate structure mirrors that of many LDCs. In particular, the use of a monthly customer charge and a variable distribution charge based on consumption to recover revenue requirements is fairly prevalent across the U.S. This particular form of rate design reflects historical industry drivers and economic conditions that are now changing in many respects.

While the basic structure of the Company's rate design is similar to that of many other LDCs, there are also differences. Many LDCs employ revenue stability mechanisms that affect revenue recovery. In addition, many firm and industrial customers of other LDCs pay a higher portion of their bills through fixed charges.

**Q.** Did the Company perform an allocated cost of service study ("ACOSS") to support the rate design recommendations?

**A.** Yes. An ACOSS provides an important means of assessing the reasonableness of existing prices and to guide the development of price changes. In particular, the ACOSS set forth in MFR Schedules H-1, H-2 and H-3 examines all of the

Company's common costs reflected in its base rate petition, and through appropriate cost assignments and allocations, establishes measures of investments, expenses and income by customer class. The ACOSS is an important tool because many of the Company's costs are common and are incurred to serve many classes of customers collectively.

The ACOSS calculates the total investment and operating costs incurred to serve each customer class, thereby establishing class-specific total revenue requirements. The class-specific revenue requirements are compared to class revenues in order to establish class income and rate of return on investment. The class-specific rates of return are used to guide the apportionment of the revenue requirements among all of Peoples' customer classes in conjunction with the development of proposed rates. The ACOSS also determines the classification of costs among demand, customer and volumetric components. The classification of costs within a rate classification is used to guide the development of the form of billing rates for that class. Although the ACOSS is not the only factor relied upon to design rates, it is an important guide to ensuring that the process is fair and reasonable.

**Q.** Please describe the general costing methodology that is incorporated in the Peoples' ACOSS.

**A.** The primary principle guiding the ACOSS process is that of cost causation. That is, each step in the development of the ACOSS is consistent with the factors that drive or contribute to the incurrence of costs on the Peoples system. One important consideration in the development of an ACOSS is an approach to allocating fixed demand costs. The Peoples ACOSS reflects a peak and average allocation of fixed demand costs that is consistent with studies performed in prior Peoples rate cases.

**Q.** Please summarize the results of the ACOSS.

**A.** The primary results from the ACOSS are the rate of return by class and the unit customer and demand-related costs. The ACOSS demonstrates that the rates of return for customers taking service on RS, RS-SG, RS-GHP, GS-3, GS-4, GS-5, SIS, IS and WHS rate schedules are less than the system-average rate of return of 2.5 percent for the test period at present rates. The rate of return for all other classes is above the system average. Table 1 of Document No. 5 in my exhibit provides a summary of the rate of return by class.

With respect to unit costs, the ACOSS indicates that the system-wide average customer cost is $22.67 per month, and the cost generally varies with the size of the customer. The lowest average customer cost of $19.65 per month is indicated for RS-SG class. A comparison of existing customer costs to customer-related costs is presented in Table 2 of Document No. 6 in my exhibit.

**Q.** Are there detailed schedules supporting these results?

**A.** Yes. MFR Schedule H-1 of the Company's MFRs provides detailed reporting of all ACOSS results. Specifically, MFR Schedule H-1, page 2 provides the allocated cost of service associated with each class, which is compared to the existing revenues to yield the class-specific revenue deficiency. Also, MFR Schedule H-2, page 3 provides a class-specific income statement showing the earned rate of return by class.

**Q.** What steps did you employ to establish the specific base rates you are proposing?

**A.** First, I determined the class-by-class revenue requirements, which reflect the results of the ACOSS and other rate design principles. Next, I evaluated the existing level of customer charges and proposed increases, where appropriate, to recover a greater proportion of customer-related costs through monthly fixed customer charges. Last, I established the appropriate rate structure and rate levels to recover the remaining portion of class revenue requirements.

**Q.** How did you develop the class-by-class revenue requirements?

**A.** The class-by-class base revenue requirements were developed by first comparing the existing base revenues to the base revenue requirements indicated by the results of the ACOSS. For purposes of developing this comparison, it is necessary to adjust existing base revenues recovered through base rates by the level of CI/BSR revenue requirements that roll-in to base rates when the CI/BSR rates are reset with the implementation of new base rates. Peoples is proposing that $23.6 million out of $28.6 million of projected 2021 CI/BSR revenue requirements will be rolled-in to base rates. I calculated the class-by-class revenues associated with the roll-in using the projected 2021 throughput and the parameters of the rider. The resulting CI/BSR roll-in revenues by class are set forth in Document No. 2 of my exhibit in Column C. The results are carried forward to Column C and reflected in the total current revenue calculation provided in Column D as shown on Document No. 3 of my exhibit. The result in Column D is compared to the revenue requirements from the ACOSS to establish the revenue deficiency by class as determined through the ACOSS.

In view of the results of the ACOSS and other important rate design goals, the Company is proposing to recover an equal percentage change in base revenues among two groups of customers: (i) residential customers taking service pursuant to Rate Schedules RS, RS-SG and RS-GHP, (ii) customers taking service pursuant to the Company's commercial rate schedules SGS, GS-1, GS-2, GS-3, GS-4, GS-5, CS-GS, CS-GHP, CSLS, and NGVS, wholesale service, and customers taking service pursuant to the Company's interruptible rate schedules SIS, IS and ISLV. This is an appropriate approach given the twelve-year time period since the Company's last base rate proceeding in 2008.

**Q.** Are you recommending any variation in the change in revenue responsibility within each of these three groups?

**A.** Yes. I am proposing Peoples apply different base revenue increases within each group of customers. Within the residential group, I am proposing the Company apply a greater proportionate increase in the base revenues for RS-1 customers. Presently, RS-1 customers pay considerably less than RS-2 and RS-3 customers even though the cost of connecting to the Peoples system is similar for most residential customers.

Within the second group, I am proposing to increase the base revenues for SIS and IS interruptible customers proportionately more than for the firm customers. Interruptible customers pay among the lowest rates on the system and the results of the COSS indicates that they are providing a return that is below the system-average at current rates. The $1.5 million incremental base revenue from interruptible classes is used to reduce the increase to SGS, GS-1 and GS-2 customers because the rates of return for these rate classes are higher than for other rate classes in this group.

**Q.** Why is the level of the monthly fixed customer charge important?

**A.** The level of the monthly fixed customer charge is important for a variety of reasons that relate to the Company’s rate design goals I described earlier. First, the monthly fixed customer charge provides customers with an important price signal concerning the impact of connecting to Peoples distribution system. Second, recovering customer-related costs through monthly fixed customer charges contributes to intra-class fairness. To the extent that a portion of customer-related costs are recovered through volumetric charges, intra-class subsidies are created as larger customers pay a disproportionate share of customer-related costs. Third, the fixed monthly customer charge provides revenue stability as fixed costs that are incurred to serve customers are recovered through a fixed charge.

**Q.** What monthly customer charges do you propose for the residential class?

**A.** I am proposing that Peoples increase the monthly customer charge for each group of residential customers and reduce the differential between the RS-1 and RS-2 monthly charges. Specifically, the proposed monthly charges are $16.20 for RS-1, $19.20 for RS-2 and $26.20 for RS-3 residential customers. The resulting average monthly charge of $20.06 is closer to the monthly customer cost indicated by the ACOSS.

**Q.** How did you derive the variable distribution charge applicable to residential customers?

**A.** The remaining revenue requirements allocated to the residential class are recovered through the variable distribution charge. The resulting distribution charge is $0.34456 per therm. The revenue increase from the residential customer charges reduces the revenue increase required through the residential delivery charge. In addition, the CI/BSR surcharge is reduced as a result of the roll-in of the CI/BS revenue requirements into base rates.

**Q.** How did you derive proposed rates for the GS customer classes?

**A.** The proposed rates for the GS classes were developed using the same approach as for the residential class. I first established an appropriate customer charge for each class. The proposed customer charge for the SGS class is $32.50 per month. Similarly, I recommend Peoples increase the customer charges for other GS classes to yield new charges that range from $48 for GS-1 customers to $1,695 per month for GS-5 customers. For each GS class, the remaining revenue requirements indicated in Document No. 3 of my exhibit are recovered through revised per-therm charges. The roll-in of the CI/BS revenue requirements results in a reduced CI/BSR surcharge to GS customers.

**Q.** How did you derive proposed rates for the interruptible customer classes?

**A.** The proposed rates for the SIS, IS and ISLV classes were developed by first establishing an appropriate customer charge and then setting the variable distribution charge to recover the remaining revenue requirements. The proposed customer charge for the SIS class is $1,695 per month and the distribution charge is $0.09002 per therm. The proposed customer charge for the IS class is $1,895 per month and the distribution charge is $0.04691 per therm. Last, the proposed customer charge for the IS-LV class is $2,095 per month and the distribution charge is $0.01151 per therm.

**Q.** Are there any additional proposed changes to the Interruptible Rate Classes?

**A.** Yes. The Company proposes that rate schedules SIS, IS and ISLV rate classes begin paying the CI/BSR effective January 1, 2021. The new rates for these customers will be determined in 2021 annual projection filing submitted in September 2020. This ensures all customers are paying the fair proportional cost of the infrastructure replacement program.

**Q.** Please describe the proposed changes to the rates for the standby generator classes.

**A.** I am proposing Peoples continue the same form of rate design, which reflects a higher fixed customer charge given these customers may go for extended periods without calling on their natural gas service. The service also reflects no distribution charge for the first 20 therms for residential standby generators and the first 40 therms for commercial standby generators. The proposed monthly customer charge for the residential standby generator class is $27.74 and the distribution charge is $0.34456. Similarly, the customer charge for commercial standby generators is 48.00, and the proposed distribution charge is $0.52937.

**Q.** Please describe the proposed changes to the rates for the gas heat pump classes.

**A.** I am proposing Peoples increase the RS-GHP fixed monthly customer charge to $26.20 and the CS-GHP fixed monthly customer charge to $48.00 These changes correspond to those for the RS-3 and GS-1 monthly customer charges. I am not proposing the Company change the distribution charges for the RS-GHP and CS-GHP services in view of the limited experience under these new services.

**Q.** Have you derived new rates for the NGVS rate class?

**A.** No. This rate schedule is currently applicable to customers that use natural gas for their vehicles (“NGV”) and has been closed to new participation as of August 1, 2013. Current fleets or customers that have initiated gas service since the closure of this rate schedule participate in the NGVS-2 or otherwise applicable RS or GS rate schedule according to their annual volumetric use. Peoples is proposing to eliminate this tariff and transfer the customers to the applicable GS rate class. Four customers are affected by the elimination of the rate class.

**Q.** Have you prepared a summary of the proposed base rate changes?

**A.** Yes. The existing and proposed rates for each class are compared in Document No. 4 of my exhibit. In addition, Document No. 3 in my exhibit provides a proof of revenues demonstrating that the proposed charges yield the requested base revenue increase based on the Company's forecasts of sales and customers.

**Q.** Does this conclude your prepared direct testimony?

**A.** Yes, it does.

(Whereupon, prefiled direct testimony of T. Mark Whitaker was inserted.)

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

**PREPARED DIRECT TESTIMONY**

**OF**

**T. MARK WHITAKER**

**POSITION, QUALIFICATION AND PURPOSE**

**Q.** Please state your name, address, occupation and employer.

**A.** My name is T. Mark Whitaker. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed by Peoples Gas System ("Peoples" or the "Company") as the Director of Gas Operations, having held that position since February 2019.

**Q.** Please describe your duties and responsibilities in that position.

**A.** As the Director of Gas Operations, I am responsible for all the daily operations. This includes the three service territories (North, Central, and South), the Measurement & Regulation functions, and Gas Control. These service territories include 14 service areas. My responsibilities include developing operating budgets and directing and planning the operation and maintenance of the gas distribution system to ensure maximum efficiency and safety of gas delivery to Peoples’ natural gas customers. I am responsible for organizational and employee development, new business development support, employee training and evaluation compliance, and compensation for all Gas Operations employees.

**Q.** Please provide a brief outline of your educational background and business experience.

**A.** I hold a Bachelor of Science in Electrical Engineering Technology (BSEET) from Georgia Southern University and a Master’s in Business Administration (MBA) from Georgia State University. My career in the natural gas industry began in 1987. I was employed by Atlanta Gas Light Company in various roles from 1987 to 2004. These roles/responsibilities included: Engineer - Technical Services, Measurement Engineer, Manager – Measurement Operations, Director – Gas Operations Support, Director – Solutions Delivery, Director of Projects – Pipeline Operations, Director of Projects–Capacity Planning. I began my employment at Peoples in January of 2004 as the Manager of Measurement and Telemetry.

I am a member of the Institute of Electrical and Electronic Engineers and have participated and presented in professional industry groups in multiple areas of operations. These groups include: 1) American Gas Association; 2) Southern Gas Association; 3) South Eastern Gas Association: and 4) Florida Natural Gas Association.

**Q.** What are the purposes of your prepared direct testimony in this proceeding?

**A.** My prepared direct testimony addresses the miscellaneous service charges in Peoples' tariff, such as charges for connecting and reconnecting service to a customer or changing the customer's name and/or address, and how the amounts of those charges were developed.

**Q.** Did you prepare any exhibits in support of your prepared direct testimony?

**A.** Yes. Exhibit No. (TMW-1) was prepared under my direction and supervision. My Exhibit consists of one document entitled:

| | |
|---|---|
| Document No. 1 | List of Minimum Filing Requirements ("MFR") Sponsored |

The information in the MFR schedules listed in Document No. 1 of my exhibit are based on the business records of the Company maintained in the ordinary course of business and are true and correct to the best of my information and belief.

**Q.** Please describe the methodology that was used in determining the costs to perform each of the tasks reflected in MFR Schedule E-3.

**A.** For each identified utility service, the Company performed a time study and cost analysis. The time study involved the capture and review of the detailed tasks involved. The tasks include customer communications, order handling, travel times, and job times. This incorporated a review and analysis of the labor and material costs required to complete each activity which were integrated into a per service cost.

**Q.** What labor and material costs were used in developing the cost of each identified task?

**A.** The Company used payroll and purchasing data as the basis for labor and material costs. As detailed in MFR Schedule E-3, the labor and material costs were adjusted to reflect the 2021 projected test year assumptions. Cost adjustments were based upon year over year cost projections.

**Q.** Where did you obtain the assumptions used to determine the 2021 projected test year rates and costs?

**A.** The labor rates and material cost assumptions used for the 2021 projected test year are discussed in Company witness Sean P. Hillary's prepared direct testimony and listed in MFR Schedule G-2 page 10.

**Q.** Is Peoples proposing any new miscellaneous service charges?

**A.** No. The Company is not proposing any new miscellaneous service charges in this proceeding.

**Q.** Is Peoples proposing any changes to the current miscellaneous service charges?

**A.** Yes. Peoples is proposing to modify several miscellaneous service charges based on the cost of the activities involved as shown in MFR Schedule E-3. The Company reviewed its miscellaneous service charges and the cost involved in performing these services. At the conclusion of this review process, various changes in the miscellaneous service charges are being proposed. These proposed changes are shown on Tariff Sheet Nos. 5.101 and 5.101-1 of the legislative versions of the revised tariff sheets contained in MFR Schedule E-9 sponsored by Company witness Luke A. Buzard.

**Q.** Please describe the MFR "I" Schedules that you are sponsoring.

**A.** I am sponsoring MFR Schedules I-1 through I-3. Each requirement is described below.

(1) MFR Schedule I-1 requires the listing of interruptions in service affecting the lesser of 10 percent or 500, or more customer meters in a division. As indicated on the schedule, there were zero interruptions of service meeting these criteria during the 2019 historic base year.

(2) MFR Schedule I-2 requires a summary of notices Peoples has received from the Commission with respect to Rule violations during the period since the last base rate proceeding, but not to exceed five years. As shown on MFR Schedule I-2, between January 1, 2015 and December 31, 2019, Peoples received 66 such notices, all of which were addressed and completed.

(3) MFR Schedule I-3 requires a listing of meters with a rated capacity of: (1) 250 cubic feet / hour ("cfh") or less which are not included in an approved statistical sampling plan; (2) between 251 cfh and 2500 cfh; and, (3)over 2500 cfh; which have not been tested for accuracy within 120 months of the 2019 historic base year end.

**SUMMARY**

**Q.** Please summarize your prepared direct testimony.

**A.** My prepared direct testimony provides an overview of the data modeling, analytical review, and charge calculations used to determine Peoples' cost of performing the activities for which miscellaneous service charges are provided in Peoples' tariff. The miscellaneous service charges cover activities, such as, providing the initial service connection for a customer, reconnecting a previously disconnected customer, and providing for final notice of termination. Peoples is proposing changes to several miscellaneous service charges based on the cost of the activities involved as shown in MFR Schedule E-3.

**Q.** Does this conclude your prepared direct testimony?

**A.** Yes, it does.

(Whereupon, prefiled direct testimony of Luke A. Buzard was inserted.)

**PEOPLES GAS SYSTEM**
**DOCKET NO. 20200051-GU**
**FILED: 06/08/2020**

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

**PREPARED DIRECT TESTIMONY**

**OF**

**LUKE A. BUZARD**

**Q.** Please state your name, address, occupation and employer.

**A.** My name is Luke A. Buzard. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed by Peoples Gas System ("Peoples" or the "Company") as the Vice President of Pipeline Safety & Regulatory Affairs.

**Q.** Please describe your duties and responsibilities in that position.

**A.** I am responsible for overseeing all aspects of the rates, compliance and regulatory matters under the jurisdiction of the Florida Public Service Commission ("Commission") for Peoples. I have also coordinated the preparation and filing of Peoples' request in this base rate proceeding. My duties also include responsibility for Peoples' safety and compliance programs, including requirements set by the Pipeline and Hazardous Materials Safety Administration (PHMSA), an agency of the Department of Transportation.

**Q.** Please provide a brief outline of your educational background and business experience.

**A.** I received my Bachelor of Science degree, with a concentration in Accounting, and my Masters of Accountancy from the College of Business Administration at the University of South Florida. Prior to my current position, my role was Director, Pipeline Safety & Operational Services, where my responsibilities included technical training, compliance, standards & technical services and employee and contractor safety. I have also previously served as the Director of Internal Audit for TECO Energy. I am a Certified Public Accountant in the State of Florida and a Certified Internal Auditor through the Institute of Internal Auditors.

**Q.** What is the purpose of your prepared direct testimony in this proceeding?

**A.** The purpose of my prepared direct testimony is to present and support the tariff modifications proposed as part of Peoples' request for an increase in base rates in this proceeding. My prepared direct testimony will describe proposed changes to Peoples' tariff, including changes to its Rules and Regulations, Rate Schedules, Standard Forms, as well as describe one new proposed tariff.

**Q.** Did you prepare any exhibits in support of your prepared direct testimony?

**A.** Yes. My Exhibit No. (LAB-1) consists of 1 document, entitled:

Document No. 1. List of Sponsored Minimum Filing Requirements ("MFRs")

The information in the MFR schedules listed in Document No. 1 of my exhibit are based on the business records of the company maintained in the ordinary course of business and are true and correct to the best of my information and belief.

**Q.** What are Peoples' proposed tariff revisions?

**A.** Peoples is proposing revisions to the following Sections of its tariff:

1. Territory Served
2. Rules and Regulations
3. Counties and Communities Served
4. Rate Schedules and Riders
5. Standard Forms

**Territory Served**

**Q.** Please describe the revisions proposed to the territory served section of the tariff.

**A.** The proposed change to the territory served is an updated map that reflects the new areas served by Peoples since its last base rate increase request in 2008.

**Rules and Regulations**

**Q.** Please describe the proposed changes to the miscellaneous charges section of the tariff.

**A.** The proposed changes to Miscellaneous Service Charges reflect the results of the cost analyses performed for these services as supported by Peoples' Witness T. Mark Whitaker in his prepared direct testimony.

**Q.** Please describe the proposed changes to the Quality section of the tariff.

**A.** Peoples proposes to modify its gas quality specification to allow Peoples, on a case by case basis, to adjust or waive the gas quality specification in order to better support the development of Renewable Natural Gas ("RNG") in Florida. Safety and operational issues will be of paramount importance in any decision to adjust or waive gas quality specifications. This modification provides greater flexibility for the

Company to allow direct injection of RNG into Peoples' system while maintaining all quality and safety standards on a system wide basis. The Company's efforts related to RNG are discussed further in Peoples' Witness Timothy O'Connor's prepared direct testimony.

**Q.** Is Peoples' proposing revisions to the Rules and Regulations section of its tariff?

**A.** Yes. Peoples is proposing revisions to Section 5, Rules and Regulations, Article VI: Main and Service Extensions of its Tariff. The Company is proposing revisions to its Maximum Allowable Construction Cost ("MACC"), which is the maximum capital cost to be incurred by the Company for an extension of main and service facilities to a customer. Where the facilities to be installed require an investment by the Company in excess of the MACC, the customer is required to pay a construction deposit in an amount equal to the excess of the estimated construction cost over the MACC. Currently, the MACC shall equal to four times the estimated annual revenue to be derived from the facilities, less the cost of gas. Peoples proposes to increase the MACC from four to 10 times the estimated annual revenue to be derived from the facilities, less the cost of natural gas.

**Q.** How have construction costs changed since the Company's last base rate proceeding in 2008?

**A.** As demonstrated in Peoples' witness Richard F. Wall's prepared direct testimony, the cost of construction has increased significantly since Peoples' last base rate proceeding, in 2008. The construction cost increases are significant enough to justify an increase to the calculation of the MACC which would provide a benefit to Peoples' customers when expanding natural gas service to a home or business.

**Q.** Is Peoples proposing any other revisions to the Rules and Regulations of the Tariff?

**A.** Yes. There are several administrative changes to the Rules and Regulations changes to the tariff. The clean and legislative versions of these changes are included in MFR E-9.

**Counties and Communities Served**

**Q.** Please describe the revisions proposed to the counties and communities served section of the tariff.

**A.** The proposed changes to the counties and communities served is an updated list that reflects the new areas to which Peoples has extended service in response to customer demand.

**Rate Schedules**

**Q.** Please describe the substantive revisions to the rate schedules and riders being proposed by Peoples.

**A.** Peoples proposes the following the revisions to the rate schedules and riders as filed with this Commission pursuant to the file and suspend provisions of Section 366.06, *Florida Statues*. The rate schedules and riders in Section 7 of the tariff reflect the new rates developed and supported by Expert witness Daniel P. Yardley's prepared direct testimony.

**Q.** Please describe other substantive proposed revisions to the rate schedules.

**A.** Peoples proposes the following additional revisions to the rate schedules:

1. Removing the Natural Gas Vehicle Service-1 rate schedule tariff. As described in Witness Yardley's direct testimony, this tariff has been closed to new customers since 2013 and existing customers will be shifted to the otherwise applicable rate schedule upon approval of new tariff rates.

2. Modifications to Natural Gas Vehicle Service-2 ("NGV-2") tariff to remove the 1.6 percent factor from the calculation. This change will provide greater flexibility to structure the facility fee based on customer needs and project specific requirements. With this change, the NGV-2 tariff facility fee will be determined in a manner consistent with the RNG tariff. The tariff change will encourage expanded use of natural gas as a transportation fuel.

3. Renewable Natural Gas Service. The proposed changes for this tariff are to support the development of RNG in Florida. The modifications will revise and clarify the types of utilized equipment, the capture of renewable natural gas and the ownership of renewable natural gas. As the RNG market in Florida begins to grow, there has been a broadening of the types of business structures for RNG projects that were not contemplated when the RNG tariff was originally added. Therefore, the Company seeks to adjust this tariff to make it applicable to the emerging business structures in the RNG arena.

4. As described in Expert witness Yardley's direct testimony, Peoples is proposing that the Cast Iron / Bare Steel Rider ("CI/BSR") rates are applicable to the

Small Interruptible Service, Interruptible Service, and Interruptible Service – Large Volume rate classes effective January 1, 2021 as these rate classes also derive a benefit from a safer and more reliable natural gas system. The proposed rates for these rate classes, along with the other rate classes, will be calculated in the annual CI/BSR projection filing due September 2020.

5. Individual Transportation Service. Peoples is proposing to make changes to its penalty calculations by changing the references from FTS-2 to FTS-3. Additionally, Peoples is proposing to change its Alert Day tolerance from 6 percent to 4.17 percent to better align with upstream capacity contracts.

**Q.** Is Peoples proposing any new tariffs?

**A.** Yes, Peoples proposes to issue a new tariff for virtual natural gas pipeline services. The Virtual Pipeline Natural Gas Service tariff ("VPNGS") is designed to serve customers that are interested in natural gas supply that cannot be served via pipeline by the Company due to the customer's need for gas versus the time it takes to construct the pipeline, the economic feasibility of constructing a pipeline to their location, or due to a customer's intermittent demand or temporary need for gas service. The VPNGS can be a temporary or interim service that allows Peoples to deliver natural gas to customers until the pipeline system exists to serve directly or can be a longer-term solution when a pipeline option does not exist.

**Standard Forms**

**Q.** Is Peoples proposing revisions to its Standard Forms?

**A.** Yes, Peoples is proposing to modernize the following Standard Forms:

1. Gas Service Agreement
2. Construction Deposit Agreement
3. Gas Bill
4. Final Notice
5. Notice and Affidavit
6. Nomination
7. Firm Delivery and Operational Balancing Agreement
8. Data Access Agreement
9. Access Form

Additionally, Peoples proposes to remove the following outdated forms, as they are no longer in effect:

1. Miscellaneous Receipt
2. Customer’s Meter Reading Card

3. Customer Service Order
4. Auto Pay
5. Contract for Interruptible Natural Gas Service

**Q.** What are the benefits of the proposed administrative revisions to the tariff?

**A.** These administrative revisions are necessary to maintain an accurate, up to date tariff.

**SUMMARY**

**Q.** Please summarize your prepared direct testimony.

**A.** The proposed revisions to Peoples' existing tariff sheets are necessary to address current and anticipated operational, business and customer needs. Taken together with the prepared direct testimony of other Peoples' witnesses, these proposed tariff revisions will permit Peoples to recover its prudent costs of providing safe and reliable natural gas utility service.

**Q.** Does this conclude your prepared direct testimony?

**A.** Yes, it does.

(Whereupon, prefiled direct testimony of Dane Watson was inserted.)

**DOCKET NO. _______-GU**
**FILED: 06/08/2020**

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

**PREPARED DIRECT TESTIMONY**

**OF**

**DANE A. WATSON**

**ON BEHALF OF PEOPLES GAS SYSTEM**

**I. POSITION, QUALIFICATION, AND PURPOSE**

**Q.** Please state your name, address, occupation and employer.

**A.** My name is Dane Watson. My business address is 101 E. Park Blvd, Suite 220, Plano, Texas 75074. I am employed by Alliance Consulting Group.

**Q.** Please describe your duties and responsibilities in that position.

**A.** I am the Managing Partner in Alliance Consulting Group ("Alliance"). As the Managing Partner of Alliance, I am responsible for performing and defending depreciation studies across the United States in a variety of regulatory proceedings. My duties include the assembly and analysis of historical and simulated data, conducting field reviews, estimating service life and net salvage estimates, calculating annual depreciation, presenting recommended depreciation rates to utility management, and supporting such rates before regulatory bodies. I have performed more than 250 depreciation studies in my career, appeared in more than 200 cases, and testified before 35 regulatory bodies as an expert witness on the subject of depreciation.

**Q.** Please provide a brief outline of your business experience.

**A.** Since graduating from college in 1985, I have worked in the areas of depreciation and valuation. I founded Alliance in 2004, and I am responsible for conducting, depreciation, valuation, and certain other accounting-related studies for utilities in various regulated industries. My prior employment from 1985 to 2004 was the Texas Utilities and successor companies ("TXU"). During my tenure with TXU, I was responsible for, among other things, conducting valuation and depreciation studies for the domestic TXU Companies. During that time, in addition to my depreciation responsibilities, I also served as Manager of Property Accounting Services and Records Management.

**Q.** What is your educational background?

**A.** I hold a Bachelor of Science degree in Engineering from the University of Arkansas at Fayetteville and a Master's Degree in Business Administration from Amberton University. I am a registered Professional Engineer in the State of Texas.

**Q.** Do you hold any special certification as a depreciation expert?

**A.** Yes. The Society of Depreciation Professionals (the "Society") has established national standards for depreciation professionals. The Society administers an examination and has certain required qualifications to become certified in this field. I met all the requirements and have become a Certified Depreciation Professional ("CDP").

**Q.** Please describe your other professional activities.

**A.** I have twice served as Chair of the Edison Electric Institute ("EEI") Property Accounting and Valuation Committee and have been Chairman of EEI's Depreciation and Economic Issues Subcommittee. I am a Senior Member of the Institute of Electrical and Electronics Engineers ("IEEE") and have held numerous offices on the Executive Board of the Dallas Section of IEEE as well as National and Worldwide offices. I have also served twice as the President of the Society of Depreciation Professionals.

**Q.** Have you previously testified before state and/or regulatory commissions?

**A.** Yes. I have testified before numerous state and federal agencies in my 35-year career in performing depreciation studies. I have conducted depreciation studies, filed written testimony, and/or testified before the Commissions identified in Exhibit No. (DAW-1).

**Q.** What is your responsibility and participation in the preparation of the Depreciation Rate Study ("the Study") for Peoples Gas System ("Peoples" or the "Company")?

**A.** I was personally responsible for, participated in, and directed all aspects of the work performed by Alliance resulting in the recommendations contained in Document No. 2 of my exhibit, the Study.

**Q.** What are the purposes of your prepared direct testimony in this proceeding?

**A.** The purpose of my prepared direct testimony is to (1) discuss the recent depreciation study conducted from Peoples' depreciable assets based on actual historical data as of December 31, 2018 and the forecasted plant and reserve balances as of December 31, 2020, and (2) support and justify the recommended depreciation rates for the Company's assets.

**Q.** Did you prepare any exhibits in support of your prepared direct testimony?

**A.** Yes. I sponsor Exhibit No. (DAW-1) consisting of three Documents prepared under my direction and supervision, entitled:

| | |
|---|---|
| Document No. 1 | List of Proceedings in which I have performed depreciation studies |
| Document No. 2 | Depreciation Study |
| Document No. 3 | Functional Summary Comparison of Depreciation Expense |

To the best of my knowledge, the information contained in my Exhibit is true and correct. .

## II. TESTIMONY STRUCTURE, DEPRECIATION DEFINTION, AND STUDY PURPOSE

**Q.** How is your prepared direct testimony structured?

**A.** My prepared direct testimony has five sections. The first two are introductory in nature.

In Section III, I explain the property included in the Study; the four-phase approach I used to conduct the Study; and the depreciation system I used for the Study.

In Section IV, I explain how depreciation rates are determined, including identifying the formula for depreciation rates. This portion of my direct testimony also explains and fully discusses each portion of the depreciation rate formula that is supported by my Study. Section IV is broken into the following subparts, which align with the components of the depreciation rate formula that the Study supports: (A) Depreciation Rate Formula; B) Life Estimation; (C) Theoretical Reserve; (D) Net Salvage Amounts and Percentages; (E) Remaining Life Analysis; and (F) Depreciation Accrual and Rates.

In Section V, I discuss the change in depreciation expense as a result of the proposed depreciation rates. Specifically, I explain why Peoples depreciation expense is increasing.

**Q.** What definition of depreciation have you used for the purposes of conducting a depreciation study and preparing your direct testimony?

**A.** The term "depreciation," as used herein, is considered in the accounting sense–that is, a system of accounting that distributes the cost of assets, less net salvage (if any), over the estimated useful life of the assets in a systematic and rational manner. Depreciation is a process of allocation, not valuation. In other words, depreciation expense allocates the cost of the asset, including any estimated net salvage (the negative of this is also known as net removal) necessary to remove the asset, as an ongoing cost of operations over the economic life of the asset. However, the amount allocated to any one accounting period does not necessarily represent an actual loss or decrease in value that will occur during that particular period. The Company accrues depreciation on the basis of the original cost of all depreciable property included in each functional property group. On retirement, the full cost of depreciable property, less the net salvage value, is charged to the depreciation reserve.

**Q.** Please generally describe the purpose of the Study.

**A.** The key functions of the Study are to: (1) determine the average service lives for Distribution and General Plant; (2) determine the net salvage percentages for Distribution and General Plant; (3) calculate the theoretical reserve of each property group based on the remaining life of the group, the total life of the group and the estimated net salvage; (4) develop depreciation rates, including an annual depreciation accrual; and (5) develop depreciation rates for plant that Peoples will add to its rate base that currently are not currently capitalized on its books.

**Q.** Based on the Study, what conclusions do you reach?

**A.** I conclude that the depreciation rates developed for Peoples' utility accounts as set forth in the Study, which is sponsored by me and included as Document No. 2 of my exhibit, encompass the best and most recent information for calculating Peoples' depreciation expense associated with these assets and are reasonable and appropriate for use in recovering the cost of Peoples' assets and net salvage.

Based on life and net salvage parameters developed and applied to forecast plant assets and depreciation reserve balances as of December 31, 2020, the depreciation rates in the Study will result in an increase in the annual depreciation expense of approximately $4.0 million per year (excluding plant with no currently approved depreciation rates). This amount was determined by comparing the depreciation expense difference between the current depreciation rates and the proposed depreciation rates as of December 31, 2020. A functional summary comparison of depreciation expense is shown in Document No. 3 of my exhibit, Schedule 1, and a more detailed comparison is shown in Appendix B of Document No. 2 of my exhibit.

## III. PEOPLES' DEPRECIATION RATE STUDY

**Q.** What is the purpose of this section of your prepared direct testimony?

**A.** In this section of my prepared direct testimony, I describe the property included in the Study; the four-phase approach I used to conduct the Study; and the depreciation system (straight-line method, Average Life Group procedure, remaining-life technique) used for the Study.

**Q.** Did the Company give you any specific information for conducting the Study?

**A.** Yes. The Company gave me the following information for the Study:

a. Historical data to analyze for life and net salvage to assist in making recommendations for Distribution and General Plant assets based on actual historical data as of December 31, 2018.

b. Plant and reserve balances to calculate the theoretical reserves and the recommended whole life and remaining life depreciation rates, including the annual depreciation expense accrual, on forecast plant and reserve balances as of December 31, 2020.

c. Information related to the operations, conditions, plans and programs was communicated to me from Company Subject Matter Experts and recorded in my Interview Notes.

d. Information regarding the new assets projected to be added during the forecast period in the gathering plant, LNG plant function, and distribution compressor function, as well as the Company's planned use of those assets.

**Q.** What property is included in the the Study?

**A.** There are two general classes, or functional groups, of depreciable property that are analyzed in the study: (1) Distribution Plant and (2) General Plant property. The Distribution Plant functional group primarily consists of pipe, numerous general and city gate stations, meters and associated facilities used to distribute gas to customers of Peoples. General Plant property is plant (such as office buildings) used to support Peoples' overall operations.

**Q.** Please describe your approach to the Study.

**A.** With the assistance of my staff, I conducted the Study in four phases as described at pages 19-21 of Document No. 2 of my exhibit. The four phases are: Data Collection, Analysis, Evaluation, and Calculation. During the initial phase of the Study, I collected historical data through December 31, 2018 to be used in the analysis. After the data was assembled, I performed analyses to determine the life and net salvage percentage for the different property groups being studied. As part of this process, I conferred with field personnel, engineers, and managers responsible for the installation, operation, and removal of the assets to gain their input into the operation, maintenance, and salvage of the assets. The information obtained from field personnel, engineers and managerial personnel, combined with the Study results, was then evaluated to determine how the results of the historical asset activity analysis, in conjunction with the Company's expected future plans should be applied. The final phase is the calculation of depreciation rates and the theoretical reserve.

The authoritative treatise, Depreciation Systems, documents the following stages of a depreciation study: "statistical analysis, evaluation of statistical analysis, discussions with management, forecast assumptions, and document recommendations. My approach mirrors this process, and following this approach ensures that Alliance comprehensively and thoroughly projects the future expectations for the Company's assets. Document No. 2 of my exhibit, page 22 shows Figure 2, which demonstrates the four phases of the Study conducted for Peoples.

**Q.** What depreciation system did you use for the Study?

**A.** The straight-line (method), the Average Life Group ("ALG") (procedure), remaining-life (technique) depreciation system was used for this Study. This is the same methodology used by Peoples and approved by this Commission for the existing depreciation rates established in Docket No. 20160159-GU.

**Q.** What is a survivor curve?

**A.** A survivor curve represents the percentage of property remaining in service at various age intervals. The Iowa Curves, the predominantly used survivor curve method in the utility industry, are the result of an extensive investigation of life characteristics of physical property made at Iowa State College Engineering Experiment Station in the first half of the prior century. Through common usage, revalidation and regulatory acceptance, the Iowa Curves have become a descriptive standard for the life characteristics of industrial property. For more detail on survivor curves see pages 13-16 of Document 2 of my exhibit.

**Q.** How are survivor curves used in the Study?

**A.** Most property groups can be closely fitted to one Iowa Curve with a unique average service life. The blending of judgment concerning current conditions and future trends along with the matching of historical data permits a depreciation analyst to make an informed selection of an account's average service life and survivor curve. When selecting an average service life, a survivor curve is also selected. When recommending depreciation rates, a depreciation analyst selects the average service life and survivor curve that are used to compute remaining life and theoretical reserve.

## IV. DETERMINATION OF THE DEPRECIATION RATES

**Q.** What is the purpose of this section of your prepared direct testimony?

**A.** In this section, I explain how depreciation rates are determined, including identifying the formula for depreciation rates. This portion of my prepared direct testimony also explains and fully discusses each portion of the depreciation rate formula that is supported by my Study.

Section IV is broken into the following subparts, which aligns with the components of the depreciation rate formula that the Study supports: (A) The Depreciation Rate Formula; (B) Life Estimation; (C) Theoretical Reserve; (D) Net Salvage Amounts or Percentages; and (E) Depreciation Accrual and Rates.

A. DEPRECIATION RATE FORMULA

**Q.** How are the depreciation rates determined?

**A.** The formula used to derive depreciation rates calculates annual depreciation accrual amounts for each group by dividing the original cost of the asset (gross plant), less book depreciation reserve, less estimated net salvage, by the group’s respective remaining life. The resulting annual accrual amounts for all depreciable property within an account are accumulated, and the total is divided by the original cost (gross plant) of all depreciable property within the account to determine the depreciation rate.

**Q.** What portion of the formula used to derive depreciation rates is supported by the Study?

**A.** The Study determines several pieces of the overall formula used to derive depreciation rates. The portions of the formula derived by the Study are:

a. Plant and Depreciation Reserve Balance: The depreciation reserve was provided by the Company with the projected gross plant balance amounts and the projected depreciation reserve as of December 31, 2020. The Study depreciation reserve balance is subtracted from gross plant.

b. Life Estimation: The Study describes the analytical tools used to estimate the appropriate average service lives and retirement survivor curve for each depreciable account.

c. Theoretical reserve: The theoretical reserve represents the portion of a property group's cost that would have been accrued as depreciation reserve if current expectations were used throughout the life of the property group for future depreciation accruals. The theoretical reserve for the asset group serves as a point of comparison to the book reserve to determine if the unrecovered investment of the asset and its removal cost are over or under-accrued.

d. Net Salvage Amounts or Percentages: The Study supports the overall net salvage percentages. The Study calculates and recommends the net salvage percentages for Distribution and General Plant accounts. For these plant accounts, salvage and removal cost percentages are calculated by dividing the current cost of salvage or removal, as supported by the Study, by the original installed cost of the retired asset.

e. Remaining Life: The Study supports the remaining life calculation by determining the appropriate average service lives and retirement survivor curve for each account.

f. Resulting Annual Depreciation Accrual and Depreciation Rates: As discussed above, the Study calculates the depreciation rates and the annual accrual amounts are then derived from these rates. The computation of the annual depreciation rates and annual accrual amounts is shown in Appendix A of the Study and are discussed in Document No. 2 of my exhibit.

B. LIFE ESTIMATION

**Q.** What method does the Study use to analyze historical data for Distribution and General plant to estimate life characteristics?

**A.** I anaylized all Distribution and General Plant accounts using the actuarial analysis (retirement rate method) to estimate the life of the property in each account. Depreciation analysts use models of property mortality characteristics that have been validated in research and empirical applications in much the same manner as human mortality is analyzed by actuaries .

**Q.** How did you determine the average service lives for Distribution and General Plant?

**A.** As noted above, I used actuarial analysis and judgment to determine the appropriate average service lives for each account in the Distribution and General functions. Graphs and tables supporting the analysis and the chosen Iowa Curves used to determine the average service lives for analyzed accounts are found in the Determination of the Lives and Net Salvage section of Document No. 2 of my exhibit, pages 27-92. A summary comparison of the approved and proposed depreciable lives is shown in Appendix C and in Schedule 3, discussed in Document Nos. 2 and 3 of my exhibit, respectively.

**Q.** Please describe some of the changes in the average service lives for the various Distribution and General accounts.

**A.** For Distribution and General Accounts, there are 18 accounts with increasing lives; four accounts with decreasing lives; 11 accounts where there is no change; and three accounts where no comparison is possible. Examples of some of the changes in average service lives for Distribution and General Plant are as follows:

a. The largest increases, 10 years and greater, in life were: Distribution Account 38400 House Regulators which increased by 20 years; Distribution Account 38300 House

Regulators by 14 years; and Distribution Account 37600 Steel Mains by 10 years.

Most of the accounts (15 out of 18) with increasing lives were 10 years or less. Further discussion of the increases is detailed for each account in the Study report.

b. The largest decreases in life were: General Account 390, Structures & Improvements, which decreased by 15 years; and Distribution Account 375, Structures and Improvements which decreased by seven years.

Distribution Account 381 Meters showed a two-year decrease in life, and General Account 393 Stores Equipment showed a one-year decrease in life.

Further discussion of the decreases is detailed for each account in the Study report.

**Q.** What method did you use in the Study to predict the life characteristics of assets that will be added during the forecast period which currently are not part of the Company’s plant-in service assets?

**A.** Since no historical data was available for those assets, I reviewed information provided by Company personnel and reviewed the life parameters used by other natural gas utilities across the nation. The proposed lives for these accounts are shown in Appendix C of the Study and are discussed in Document No. 2 of my exhibit, pages 93-98.

C. THEORETICAL RESERVE

**Q.** What purpose does the theoretical reserve serve in the Study?

**A.** The theoretical reserve represents the portion of a property group's cost that would have been accrued as depreciation reserve if current life and net salvage expectations were used and achieved throughout the life of the property group for depreciation accruals. The theoretical reserve for the asset group serves as a point of comparison to the book reserve to determine if the unrecovered investment of the asset and its removal cost are over or under-accrued.

**Q.** How did you determine the theoretical reserve reflected in the Study?

**A.** I computed the theoretical reserves in the Study based on projected plant balances as of December 31, 2020. The theoretical reserve was calculated using a reserve model that relies on a prospective concept relating future retirement and accrual patterns for property, given current life and salvage estimates. More specifically, the theoretical reserve of a property group was determined from the estimated remaining life of the group, the total life of the group, and estimated net salvage. This computation for the straight-line, remaining-life theoretical reserve ratio, which I describe in more detail on page 19 of Document No. 2 of my exhibit, involved multiplying the vintage balances within the property group by the theoretical reserve ratio for each vintage.

**Q.** Is it desirable for the depreciation reserve to conform to the theoretical reserve?

**A.** Yes. It is desirable for the depreciation reserve to conform as closely as possible to the theoretical reserve. When remaining life rates are used, the theoretical reserve provides the basis for any over-accrual or under-accrual in setting the depreciation rates at the appropriate level based on current parameters and expectations.

**Q.** How do the book and theoretical reserve compare in this Study?

**A.** As shown in Document No. 2 of my exhibit, Appendix E, the theoretical reserve is lower than the book reserve, creating a surplus that is netted over the remaining life of the account and has the effect of decreasing the depreciation rate. Rates by account for Distribution and General are shown in Document No. 2 of my exhibit, Appendix B.

Overall, the Study found a surplus of $245.6 million at December 31, 2020 based on the recommended life and net salvage parameters. The depreciation rates are designed to eliminate that surplus over the remaining life of the distribution depreciable assets and the average remaining life for the accounts where the Company is proposing general plant amortization.

**Q.** How was the difference between the book and theoretical reserve handled in the Peoples' last depreciation study?

**A.** The Florida Public Service Commission ("FPSC" or "Commission") approved the use of remaining life to amortize that amount in Docket No. 20160159-GU. This Study proposed the same methodology.

D. NET SALVAGE AMOUNTS OR PERCENTAGES

**Q.** What is net salvage as determined for all the Company's plant assets?

**A.** While discussed more fully in the Study itself, net salvage is the difference between the gross salvage (what the asset was sold for) and the cost of removal (cost to remove and dispose of the asset) ("COR"). If the COR exceeds gross salvage, net salvage is negative. Some plant assets can experience significant negative removal cost percentages due to the amount of removal cost and the timing of any capital additions versus the retirement.

Salvage and removal cost percentages are calculated by dividing the current cost of salvage or removal by the original installed cost of the assets retired.

**Q.** How did you determine the net salvage percentages for each asset group in Distribution and General plant?

**A.** I started by using an industry-standard method that divides the current cost of removal and salvage by the original installed cost of the assets retired. However, I also applied judgment also to select a net salvage percentage that represents the future expectations for each account. In applying this judgment, I compiled and considered historical salvage and removal data by account to determine values and trends in gross salvage and removal cost. The account data for retirements, gross salvage, and COR covered the period from 1983 - 2018 and is detailed in the Study. I calculated moving averages with this data, with the intent to remove timing differences between retirement and salvage and removal cost; I analyzed those moving averages over varying periods up to 10 years. These calculations are shown in Appendix D of Document No. 2 of my exhibit.

**Q.** Is it sufficient to only analyze historical data to form your life and net salvage estimates?

**A.** No. Historic life and salvage data are the primary factors to consider in making life and net salvage recommendations but it is crucial to incorporate future trends, changes in equipment and Company-specific operational information before finally making life and net salvage recommendations. Once all the calculations and data are prepared, I applied professional judgment, considered Company expectations and trends, and evaluated the magnitude of the potential change to determine the appropriate net salvage percentages. A comparison of the approved and proposed net salvage percentages is shown in Document No. 3 of my exhibit, Schedule 2 and in Document No. 2 of my exhibit, Appendix C.

**Q.** Please describe the major changes in the net salvage percentages for the various accounts.

**A.** The detailed analysis of each account is described fully in Document No. 2 of my Exhibit, starting at pages 24-26. Net salvage is trending toward higher negative net salvage due to the increased costs of labor, safety, and environmental associated with retiring utility assets and the longer lives being experienced for many assets. For Peoples, net salvage in 12 accounts decreased (became more negative) while three increased (became less negative or more positive) 18 accounts remained unchanged, while for the remaining three accounts, no comparison could be made. Examples of some of the changes in net salvage are:

a. The most significant changes of 20 percent or more (more negative) in net salvage percentages were in: Distribution Account 376.00, Steel Mains, which decreased from negative 40 to negative 60 percent; Distribution Account 380.00, Steel Mains, which decreased from negative 100 percent to negative 150 percent; and Distribution Account 380.2, Plastic Services, which decreased from negative 55 percent to negative 80 percent.

b. The most significant increase in net salvage percentage was for General Plant Account 396.00 which increased from a positive 5 percent to positive 10 percent net salvage.

In addition to the account specific detail, general factors impacting removal costs are discussed in the Study. See Document No. 2 of my exhibit, pages 24-26.

**Q.** How did you determine the net salvage percentages for accounts where no history exists?

**A.** Currently, there is no authorized net salvage for Accounts 33600 Renewable Natural Gas (“RNG”), 36400 Liquefied Natural Gas (“LNG”), and 37700 Compressor Equipment. While it is reasonable to expect cost of removal to exceed salvage for these assets, there is no historical basis at this time for a recommendation. I recommend a negative five percent is recommended for each of these assets at this time and that this recommendation be evaluated as the Company gains actual experience with these assets

E. REMAINING LIFE

**Q.** Having determined the theoretical reserve, the book reserve, calculated net salvage, please describe how you used the remaining life for each account to calculate the depreciation rates and annual depreciation accrual expense.

**A.** I used a three-step process to determine the remaining life for each account. First, I used historic data through December 31, 2018 and applied judgment to estimate life and net salvage parameters. Then, I developed the vintage balances and reserves as of December 31, 2020.

Using those inputs, I estimated the remaining life for each vintage in the group by applying the proposed average life and dispersion curve by vintage and computing the direct weighting remaining life for each plant account.

F. DEPRECIATION ACCRUAL RATES

**Q.** Please describe the final steps in calculating the depreciation rates and annual depreciation accrual expense.

**A.** I used a two step process to calculate the depreciation rates. In the first step, as discussed earlier, I used historical data through December 31, 2018, Company information and judgment to estimate life and net salvage parameters. I then used the vintage balances and reserves at December 31, 2020 to compute the proposed depreciation accrual expense and rates using the estimated life and net salvage parameters.

In the Study, I calculated the depreciation accrual rates using the same methodology as was used in developing the depreciation rates approved by the Commission in Docket No. 20160159-GU. More discussion on the computation of accrual rates is found in the Study and the calculation are shown in Appendix A of Document No. 2 of exhibit.

**V. CHANGE IN DEPRECIATION EXPENSE AS A RESULT**

**Q.** What is the purpose of this section of your prepared direct testimony?

**A.** In this section of my prepared direct testimony, I discuss the change in depreciation expense as a result of the proposed depreciation rates. Specifically, I describe the changes in depreciation expense and explain why Peoples' depreciation expense is increasing.

**Q.** Please summarize the Study results with respect to changes in depreciation expense.

**A.** Based on the depreciation rates indicated in the Study, as applied to forecasted plant balances as of December 31, 2020, the overall change in annual depreciation expense is an increase of approximately $3.8 million for currently existing asset classes. Document No. 3 of my exibit, Schedule 1, shows this increase reflects an increase of $5.9 million in Distribution, a decrease of $2.1 million in General and a decrease of $49 thousand for intangible property.

There are two asset types Mains (376) and Services (380) in the Distribution function, that are driving the increase. Account 37600 Steel Mains and 38000 Steel Services both saw more negative net salvage with life increases as a partial offset. Account 37602 Plastic Mains and 38002 Plastic

Services both retained the same average service lives and dispersion, with more negative net salvage. Since these are the Company's largest accounts, the impact is an increase in depreciation expense compared to the existing rates.

**Q.** Have you proposed depreciation rates for certain expected plant additions?

**A.** Yes. In the Study we have included a proposed life, net salvage and resulting depreciation rate for the Company's pro-forma plant additions which include; 33600 RNG, 36400 LNG plant, and 37700 Distribution Compressors. We understand these assets are expected to go into service in 2021. However, from an accounting perspective, having a depreciation rate to apply to an asset class when the assets are placed in service is necessary. Peoples requests a rate to apply to those assets when they are closed to plant in service, which is expected to occur by the end of calendar year 2021. The depreciation expense on these assets added in 2021 is proposed to be $2.3 million annually.

**VI. CONCLUSION**

**Q.** Mr. Watson, do you have any concluding remarks?

**A.** Yes. The Study and analysis performed under my supervision fully supports setting depreciation rates at the level I have indicated in my testimony. The Company should continue to periodically review the annual depreciation rates for its property. In this way, the Company's depreciation expense will more accurately reflect its cost of operations and the rates for all customers will include an appropriate share of the capital expended for their benefit.

The Study analysis for Peoples' depreciable property for actual plant assets as of December 31, 2018 describes the extensive analysis performed. The forecast plant balances and reserves at December 31, 2020 result in rates that are now appropriate for Company property.

**Q.** Does this conclude your prepared direct testimony?

**A.** Yes, it does.

(Transcript continues in sequence in Volume 3.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA )
COUNTY OF LEON )

I, DEBRA KRICK, Court Reporter, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED this 8th day of December, 2020.

Debbie R Krick

DEBRA R. KRICK
NOTARY PUBLIC
COMMISSION #HH31926
EXPIRES AUGUST 13, 2024