

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 110138-EI

TESTIMONY AND EXHIBIT
OF
SCOTT C. TWERY AND ANNE E. CRUMLISH



COM 5
APA |
ECR 10
GCL |
RAD |
SSC |
ADM |
OPC |
CLK Ch. RPR

DOCUMENT NUMBER-DATE
04678 JUL-8 =
FPSC-COMMISSION CLERK

1 GULF POWER COMPANY

2 Before the Florida Public Service Commission
3 Prepared Direct Testimony of
4 Scott C. Twery and Anne E. Crumlish
5 Docket No. 110138-EI
6 In Support of Rate Relief
7 Date of Filing: July 8, 2011

8 Q. Mr. Twery, please state your name, business address and occupation.

9 A. My name is Scott C. Twery. My business address is 3350 Riverwood
10 Parkway, Suite 80, Atlanta, GA 30339. I am a Principal and Consulting
11 Actuary in Aon Hewitt's retirement practice. Aon Hewitt is a global market
12 leader in Human Resources consulting and outsourcing with 29,000
13 colleagues serving more than 20,000 clients.

14 Q. Please summarize your educational and professional background.

15 A. I have worked for over 30 years as an actuary consulting with companies
16 about their retirement benefit programs. I am a Fellow of the Society of
17 Actuaries and an Enrolled Actuary. I earned a Bachelor of Science in
18 mathematical sciences with an actuarial science emphasis. I have
19 consulted with Gulf Power Company (Gulf, or the Company) and Southern
20 Company for over 20 years on their benefit programs. During that period, I
21 have led actuarial teams that have determined the companies' retirement
22 benefit costs and consulted with them on benefit competitiveness.

23

24

25

1 Q. Ms. Crumlish, please state your name, business address and occupation.

2 A. My name is Anne E. Crumlish. My business address is 3350 Riverwood
3 Parkway, Atlanta, GA 30339. I am a Principal and Consulting Actuary in
4 Aon Hewitt's health and benefits practice.

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

7 A. I have over 10 years of experience as a health care consultant and
8 actuary. I am a Fellow of the Society of Actuaries and a Member of the
9 American Academy of Actuaries. I earned a Bachelor of Arts in
10 Mathematics and Master of Arts in Mathematics with a focus in actuarial
11 science. I have served as Southern Company's and Gulf's health care
12 actuary for over nine years. I currently lead an actuarial team that
13 determines the companies' health care benefit costs and consults with
14 them on benefit design and competitiveness.

15
16 Q. Are you sponsoring any exhibits in this case?

17 A. Yes. We are sponsoring the following three schedules which are attached
18 to our direct testimony:

- 19 • Exhibit SCT-1, Schedule 1, Aon Hewitt Comparison of
20 Employer-Provided Total Benefit Values
- 21 • Exhibit AEC-1, Schedule 1, National Employer Health Plan
22 Average Annual Cost Increases, 2001-2012
- 23 • Exhibit AEC-1, Schedule 2, Medical Plan Cost Mitigation Efforts
24 2003-2012

25

1 Q. What is the purpose of your testimony?

2 A. The purpose of our testimony is to describe the relative competitiveness of
3 Gulf's overall benefits program, give reasons why retirement benefit costs
4 have increased, and explain why medical benefit costs have increased.
5 Ms. Crumlish will address medical benefit costs. Mr. Twery will address
6 the other two topics.

7

8 Q. Are the benefits programs provided to Gulf's employees, Southern
9 Company plans or Gulf plans?

10 A. Most of the benefit plans are Southern Company plans. Managing a
11 benefit plan for all of Southern Company is more cost effective than
12 maintaining separate plans for each subsidiary. Even so, the costs
13 determined for Gulf are directly attributable to Gulf's employees. For
14 example, when Gulf's retirement benefit costs are determined, the
15 calculations only involve Gulf's employees and Gulf's portion of retirement
16 plan assets. Another example is Gulf's health care benefit costs. These
17 costs are an allocation of pooled expenses determined by the actual plan
18 option and family coverage tiers selected by each Gulf employee. All
19 references in the remainder of our testimony will be to Gulf, even if the
20 plan is administered by Southern Company.

21

22 Q. As a result of your work for Gulf, are you familiar with the Company's
23 overall benefits philosophy?

24 A. Yes. My understanding is that the Company has a goal for its benefits to
25 be at the median of the market.

1 Q. Has Aon Hewitt made an assessment of how Gulf's benefits compare to
2 the market and if so, how does Gulf's benefit package compare to the
3 market?

4 A. Yes. We performed an assessment of Gulf's benefits and we found them
5 to be competitive with other large utilities and Fortune 500 companies.
6

7 Q. What is the basis of your conclusion that Gulf's benefits are competitive?

8 A. Our response is based on a benefits competitiveness analysis we made of
9 the benefits that Gulf and the comparator companies offered in 2010. The
10 analyses were done using Aon Hewitt's Benefit Index®. The Benefit Index
11 is a premier tool for comparing the relative worth of one company's benefit
12 programs to those offered by a group of other companies. It has been
13 used by companies since the 1970s to make such assessments.
14

15 When last assessed, the relative value of benefits Gulf provides its
16 employees is 5.8 percent below the average value of benefits provided by
17 15 other large utilities and 4.6 percent above the average value of benefits
18 provided by Fortune 500 companies. Generally, value differences are not
19 considered significant or material until they exceed 5 percent. So it is fair
20 to say that Gulf-provided benefits are slightly less valuable than those at
21 other large utilities and nearly in line with those at Fortune 500 companies.
22

23 Q. How were the benefit competitiveness assessments made?

24 A. Benefit Index results are arrived at using a very specific process.
25 Actuarial techniques are used to measure the total value a representative

1 population of employees would derive from Gulf's benefits program and
2 the benefits programs of each of the comparator companies. All
3 retirement income, death, disability, healthcare, and paid time off benefits
4 offered to salaried hires are included. These actuarial values reflect the
5 benefits that each program would be expected to pay during a year and
6 the present value of the benefits employees would be expected to earn
7 during a year but receive in the future, like pension benefits. The same
8 employee population and assumptions are used when measuring the
9 values for each of the programs. This standardization assures that the
10 differences in benefit values are attributable to plan designs. Finally, the
11 value of Gulf's benefits program is compared to the average of the values
12 for the comparator group's programs to arrive at a relative value result
13 reported by the Benefit Index. A relative value of 100.0 would be assigned
14 if Gulf's benefit value equaled the average value of the benefits offered by
15 the comparator companies.

16
17 Benefit Index relative values for Gulf's benefits versus the 15 large utilities
18 and Fortune 500 comparator groups were 94.2 and 104.6 respectively.
19 The 94.2 indicates Gulf's standardized value of benefits was 5.8 percent
20 below the average of the utilities and the 104.6 indicates that Gulf's
21 standardized value of benefits was 4.6 percent above average for the
22 Fortune 500 comparators.

23
24 Exhibit SCT-1, Schedule 1, contains a chart showing the relative value of
25 Gulf's benefits versus the average of two comparator groups. In addition,

1 that chart shows the distribution of the relative values of comparator
2 companies' benefits around the average. As shown on that chart, the
3 median of each comparator group is essentially the same as the average.
4 For that reason, market average and market median are effectively the
5 same for purposes of this competitive analysis.
6

7 Q. The title on Schedule 1 of Exhibit SCT-1 refers to "Employer-Provided
8 Total Benefit Values." Please explain.

9 A. Two scores are actually produced in the Benefit Index study. One is Total
10 Benefit Value which reflects the full value of the benefits program. The
11 other reflects only Employer-Provided Benefit Value which is the Total
12 Benefit Value reduced by the value of employee/retiree contributions
13 required to receive the benefits. For market competitiveness, the
14 Employer-Provided Benefit Value is normally used since it represents the
15 portion of benefits for which companies pay. Gulf's Total Benefit Values
16 versus both the utility and Fortune 500 comparator groups were just a bit
17 higher than its Employer-Provided Benefit Values. This indicates Gulf is
18 charging its employees/retirees more for benefits than the comparator
19 companies do on average.
20

21 Q. Did you recently provide revised retirement benefit expense projections to
22 Gulf?

23 A. Yes. In March 2011, I provided updated expense projections for pensions,
24 retiree medical, and retiree life benefits based on the formal actuarial
25 measurements done as of the end of 2010. The new projections portray

1 lower 2011 and 2012 expenses for these benefits than earlier projections
2 did. The decline is attributable to 2010 events and related changes in
3 estimates. I have been informed that these revised projected expenses for
4 the 2012 test year are in total \$2.7 million lower than the estimate
5 contained in the Company's 2011 financial model. I also understand that
6 Gulf Witness McMillan makes an adjustment to reflect this expense
7 reduction in the Company's rate request.
8

9 Q. Did Gulf Witness Erickson provide you with information on Gulf's projected
10 A&G O&M benefits costs for the 2012 test year and how they compare to
11 the Commission's O&M benchmark?

12 A. Yes. Ms. Erickson informed us that Gulf's total projected A&G O&M
13 benefit costs for the test year are approximately \$20.7 million, which is
14 approximately \$10.1 million above the benchmark. Ms. Erickson states in
15 her testimony that the projected retirement plan expense is \$6.9 million
16 above the benchmark, and projected medical plan and group insurance is
17 \$3.3 million above the benchmark. Also, she has informed us that primary
18 contributors to the \$6.9 million and \$3.3 million differences were the
19 pension and medical benefit expenses, respectively. The explanations we
20 provide about why pension and medical benefit expenses have increased
21 will also explain other variances that we understand are attributable to
22 these benefit costs, including those Ms. Erickson's testimony has identified
23 as related to joint ownership and duplicate charges.
24
25

1 Q. Why have pension expenses increased by as much as they have since
2 the costs were projected for the prior 2002-2003 test year?

3 A. Pension cost increases are attributable to a number of factors, but the
4 primary factor has been measurement losses. Simply put, pension plan
5 assets are less than they had been anticipated to be and liabilities are
6 higher than they had been expected to be. These losses offset some of
7 the gains that Gulf experienced in prior years. Due to those gains, Gulf
8 had more pension assets than liabilities for quite a few years, and Gulf's
9 pension expenses were actually negative for quite some time, including
10 the last test year. In other words, Gulf's pension was actually contributing
11 to income in spite of Gulf's employees earning benefits each year. The
12 losses and liabilities associated with the normal benefit accruals have
13 finally eroded the surplus resulting from the prior gains, and pension
14 expenses are projected to be higher as a result. Note that the pension
15 expenses being referred to are calculated for the Company's accounting
16 and financial reporting purposes. They are determined according to very
17 specific rules set out by the Financial Accounting Standards Board.

18

19 Q. What has been the source of these pension losses?

20 A. There have been two primary sources. First, while pension plan assets
21 earned about \$102 million of return over the period from when the last test
22 year's costs were projected through 2010, that amount is about \$123
23 million less than the returns that had been expected during that period.
24 Nearly all of these reduced investment earnings result from the stock
25 market crash early in the century and the 2008 "Great Recession."

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

Second, pension benefit liabilities are about \$67 million higher than had been anticipated. Out of the many factors influencing the size of liabilities, the change in the level of discount rates explains the vast majority of the additional liabilities. Essentially, these liabilities are the present values of the pension benefits that Gulf employees have earned and are expected to receive in the future. The discount rate currently being used is about 200 basis points lower than the discount rate used when pension expenses for the last test year were projected. That is because GAAP accounting rules mandate discounting the future benefit payments using market interest rates, and these market rates are significantly lower today. The lower rate of discount pushes up the pension liabilities.

Gulf's situation is not unique. Essentially, all pension plan sponsors incurred losses during the period since costs were projected for the last test year due to the general economic circumstances that caused interest rates to fall and investments to perform poorly.

- Q. What has Gulf done to manage retirement benefit costs?
- A. Gulf has made a number of plan changes that put fixed dollar limits on the size of retiree medical and retiree death benefits. This type of limit is an effective way of capping the Company's obligations. For example, impacted retirees now must pay all of the increase in the cost of medical coverage each year, because the Company's share of the annual cost of coverage has been limited to a fixed dollar amount. The most recent plan

1 change was the imposition of a \$12,500 maximum on retiree death
2 benefits payable to survivors of non-bargaining unit employees who retire
3 after January 1, 2011 and who die after attaining age 65. Prior to the
4 change, impacted employees could anticipate benefits as high as 75
5 percent of final base pay. In large part due to these changes that Gulf has
6 made, the projected 2012 expense for these two retirement benefits are
7 actually lower than they were in the prior test year.

8

9 Q. What has caused medical plan costs to increase by as much as they have
10 since the costs were projected for the prior 2002-2003 test year?

11 A. Medical plan costs are increasing faster than general inflation all across
12 the U.S. and at the Company due to factors that include:

- 13 • Price increases in provider reimbursements driven, in part, by an
14 increase in the number of uninsured individuals and by cost shifting
15 from the Medicare and Medicaid programs;
- 16 • Increased utilization of inpatient and outpatient care, as well as
17 pharmaceutical therapies. These increases are driven by:
 - 18 ○ An aging U.S. population,
 - 19 ○ Increased prevalence of chronic disease,
 - 20 ○ Continued focus on direct consumer advertising by
21 pharmaceutical companies, and
 - 22 ○ Threat of malpractice leading physicians to practice
23 defensive medicine;
- 24 • Adoption of more complex therapies in place of lower cost
25 treatments, increasing the intensity of care delivered;

- 1 • Technological enhancements in medical treatments, therapies and
2 services driving greater utilization and cost; and
3 • Provisions in health care legislation requiring coverage
4 improvements and introducing new fees and taxes to the health
5 care industry.

6

7 These factors have impacted employer plans quite broadly. As shown in
8 Schedule 1 of Exhibit AEC-1, employer health plan cost increases have
9 averaged 7.6 percent per year from 2001 to 2012. Increases in the utility
10 industry have been slightly higher (8.6 percent per year). Gulf's plan
11 increases of 8.8 percent are in line with the utility industry.

12

13 Q. What has Gulf Power done to mitigate medical plan cost increases?

14 A. The increasing cost of health care is a national concern, and controlling
15 costs while providing quality medical coverage will continue to be a top
16 priority for Gulf. Since 2003, Gulf has implemented many initiatives to
17 control health care expenses. Listed below are some examples, with
18 more savings detail provided on Schedule 2 of Exhibit AEC-1:

- 19 • Merged Gulf's medical plan into a larger Southern Company plan to
20 reduce plan experience fluctuations and administrative costs;
21 • Annually adjusted employee contributions;
22 • Consolidated Pharmacy Benefit Manager (PBM) services to lower
23 vendor administrative fees;
24 • Successfully renegotiated the administrative services contract with
25 the PBM several times during this period;

- 1 • Implemented numerous prescription drug purchasing and price
2 controls for using generic drugs, mail order, etc.;
- 3 • Conducted dependent eligibility reviews and removed ineligible
4 dependents;
- 5 • Implemented comprehensive wellness and disease management
6 programs for employees;
- 7 • Added emphasis on employee responsibility to manage individual
8 health care costs; and
- 9 • Applied for and received Retail Drug Subsidy (RDS) and Early
10 Retirement Reimbursement Program (ERRP) payments from the
11 Federal Government to help offset some of the cost increases.

12

13 Each of these changes resulted in significant savings in the year of the
14 change as documented in Schedule 2 of Exhibit AEC-1. Most of these
15 changes also generated ongoing savings in subsequent years, though the
16 ongoing savings are difficult to quantify in a cumulative manner.

17

18 With these significant efforts, Gulf has been able to manage medical plan
19 cost increases and maintain competitive health insurance benefits for its
20 employees. As a result, Gulf's medical plan cost increases are in line with
21 the utility industry, but slightly higher than the national average.

22

23 Q. Please summarize your testimony.

24 A. Gulf's benefits are reasonable for two primary reasons. Their value is
25 generally in line with the average value of benefits offered by Fortune 500

1 companies and slightly below the average value for 15 other large utilities.
2 Also, the benefits are in line with the Company's philosophy of having total
3 benefits at the median of market.

4

5 The increase in Gulf's retirement benefit costs is primarily attributable to
6 increases in pension expense due to losses resulting from falling interest
7 rates and poor market performance. Nearly all pension plans experienced
8 losses for these same reasons. Gulf's retiree medical and death benefit
9 expenses have not increased in large part due to the benefit limitations
10 that the Company has imposed.

11

12 Gulf has experienced health care cost increases since its last rate case
13 that are in line with industry averages. While Gulf's cost increases are
14 slightly higher than national averages, this is explained by industry norms.
15 Gulf has continuously worked to manage its health care plan to control
16 health care costs and maximize efficiencies while maintaining a
17 competitive level of benefits for its employees.

18

19 Q. Does this conclude your testimony?

20 A. Yes.

21

22

23

24

25

AFFIDAVIT

STATE OF GEORGIA)
)
COUNTY OF COBB)

Docket No. 110138-EI

Before me the undersigned authority, personally appeared Scott C. Twery, who being first duly sworn, deposes, and says that he is a Managing Principal of Aon Hewitt, that the foregoing is true and correct to the best of his knowledge, information, and belief. He is personally known to me.

Scott C Twery

Scott C. Twery
Managing Principal

Sworn to and subscribed before me this 6th day of July, 2011.

Jana M. Flatebo
Notary Public, State of Georgia

JANA M FLATEBO
NOTARY PUBLIC
COBB COUNTY, GEORGIA
MY COMMISSION EXPIRES NOVEMBER 25, 2011

Commission No. _____

My Commission Expires 11-25-2014

AFFIDAVIT

STATE OF GEORGIA)
)
COUNTY OF COBB)

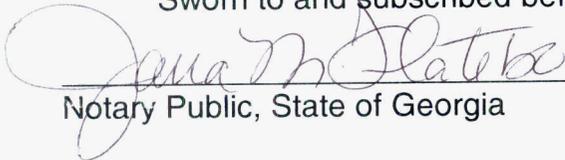
Docket No. 110138-EI

Before me the undersigned authority, personally appeared Anne E. Crumlish, who being first duly sworn, deposes, and says that she is a Principal of Aon Hewitt, that the foregoing is true and correct to the best of his knowledge, information, and belief. He is personally known to me.



Anne E. Crumlish
Principal

Sworn to and subscribed before me this 6th day of July, 2011.



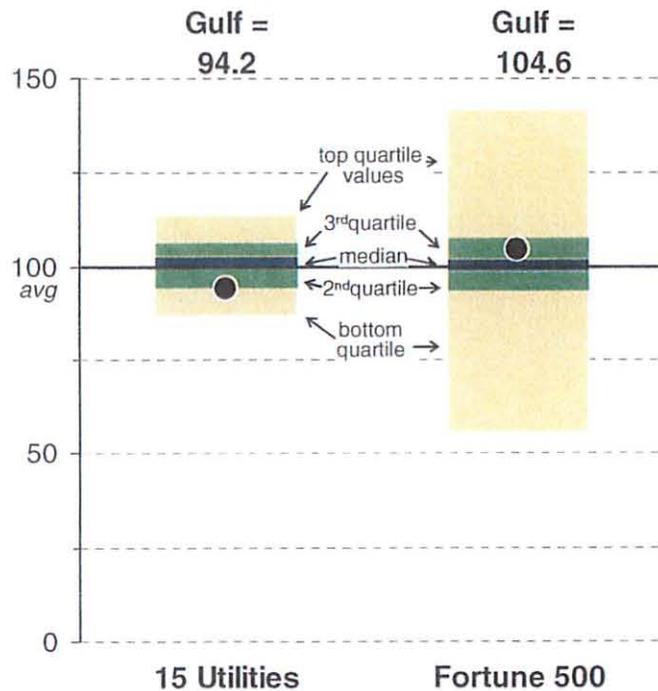
Notary Public, State of Georgia

JANA M FLATEBO
NOTARY PUBLIC
COBB COUNTY, GEORGIA
MY COMMISSION EXPIRES NOVEMBER 25, 2014

Commission No. _____
My Commission Expires 11-25-2014

Gulf's Benefits versus Utilities' and Fortune 500 Companies' Benefits

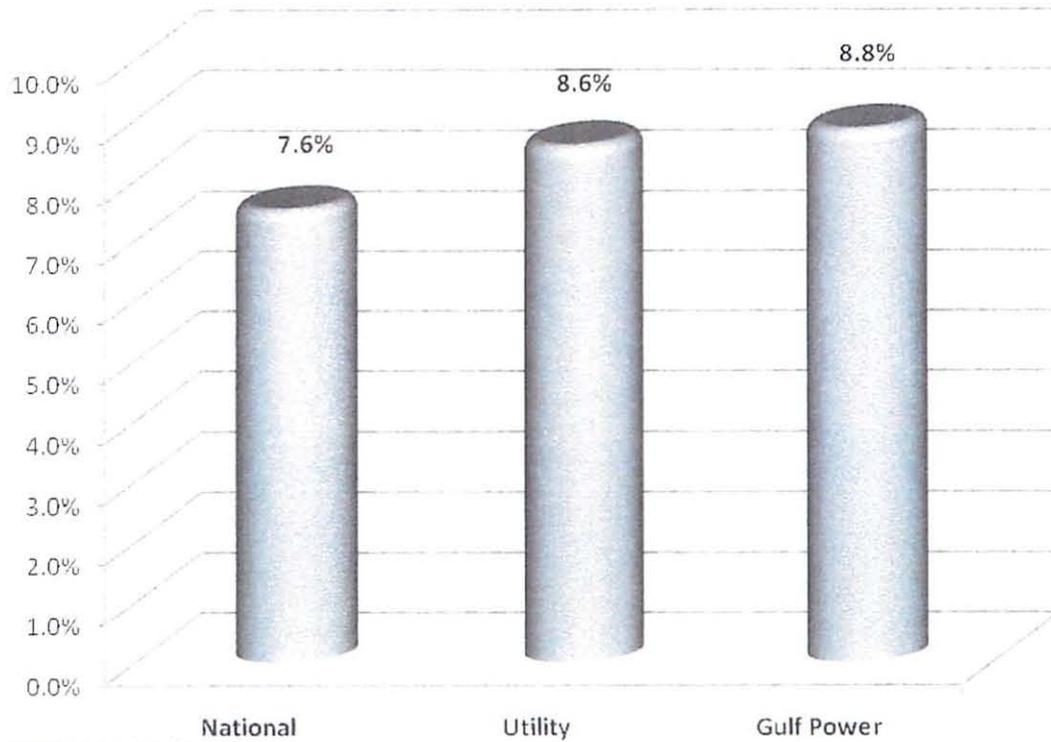
Comparison of Employer-Provided Total Benefit Values



- Columns represent distribution of comparator companies' benefit values segmented by quartiles
- Average of values for each comparator = 100
 - 94 means benefit value 6% below average value vs. the comparator group
 - 104 means 4% above average value vs. the comparator group
- Source: 2010 Aon Hewitt Benefit Index® study of Gulf Power benefits versus benefit values for 15 utilities and 248 of the Fortune 500 companies in Benefit SpecSelect™ database



National Employer Health Plan Average Annual Cost Increases, 2001-2012



Data Source: Aon Hewitt

**Medical Plan Cost Mitigation Efforts
For Active and Retired Employees
2003 – 2012**

Year	Action Taken	Estimated Savings In The Year of Change
2003	Adopted Southern Company PPO plans and pooled claims experience to reduce plan fluctuations	\$830,000
2004	Consolidated Pharmacy Benefits Mgr (PBM) with Southern Company and competitively bid Rx benefit	\$100,000
2005	Further consolidation of PBM services	\$120,000
2006	Renegotiated PBM contract; negotiated lower admin fees; dependent verification audit; retiree drug subsidy reimbursements*	\$470,000
2007	Retiree drug subsidy reimbursements*	\$300,000
2008	Renegotiated PBM contract; dependent eligibility audit; disease management implemented; retiree drug subsidy reimbursements*	\$530,000
2009	Dependent eligibility audit; retiree drug subsidy reimbursements*	\$420,000
2010	Renegotiated PBM contract; implemented Rx purchasing controls; retiree drug subsidy reimbursements*	\$640,000
2011	Early retirement reinsurance program funds**; retiree drug subsidy reimbursements*	\$920,000
2012	Early retirement reinsurance program funds**; retiree drug subsidy reimbursements*; implement Rx purchasing controls for Medicare retirees	\$650,000

* Title I of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) contains the provisions governing the special retiree drug subsidies and other options that were designed to encourage employers and unions to continue providing high quality prescription drug coverage to their retirees. RDS reimburses the Plan for certain prescription drug costs incurred by retiree medical plan participants. Part of the subsidy is used to reduce costs for retirees insured under the Plan.

** The Early Retiree Reinsurance Program (ERRP) provides reimbursement to participating employment-based plans for a portion of the costs of health benefits for early retirees and early retirees' spouses, surviving spouses, and dependents. The program was authorized in the Affordable Care Act.