BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the matter of:

DOCKET NO. 20220067-GU

Petition for rate increase by Florida Public Utilities Company, Florida Division of Chesapeake Utilities Corporation, Florida Public Utilities Company - Fort Meade, and Florida Public Utilities Company - Indiantown Division.
_______________________________________/

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PROCEEDINGS: HEARING

COMMISSIONERS
PARTICIPATING: CHAIRMAN ANDREW GILES FAY
COMMISSIONER GARY F. CLARK
COMMISSIONER GABRIELLA PASSIDOMO

DATE: Wednesday, October 26, 2022

TIME: Commenced: 9:30 a.m.
Concluded: 4:15 p.m.

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

REPORTED BY: DEBRA R. KRICK
Court Reporter

APPEARANCES: (As heretofore noted.)

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112 W. 5TH AVENUE
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I N D E X

P R O C E E D I N G S

(Transcript follows in sequence from Volume 6.)

(Whereupon, prefiled direct testimony of Ralph C. Smith was inserted.)

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for Rate Increase by Florida Public Utilities Company, Florida Division of Chesapeake Utilities Corporation, Florida Public Utilities Company – Fort Meade, and Florida Public Utilities Company – Indiantown Division	Docket No. 20220067-GU Filed: August 24, 2022

DIRECT TESTIMONY

OF

RALPH SMITH, CPA

ON BEHALF OF THE CITIZENS OF THE STATE OF FLORIDA

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RCS-2, Revenue Requirement and Adjustment Schedules for Projected 2023 Test Year

DIRECT TESTIMONY

OF

RALPH SMITH

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

Docket No. 20220067-GU

I. INTRODUCTION

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

A. My name is Ralph Smith. I am a Certified Public Accountant licensed in the State of Michigan and a senior regulatory consultant at the firm Larkin & Associates, PLLC, Certified Public Accountants, with offices at 15728 Farmington Road, Livonia, Michigan, 48154.

Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES, PLLC.

A. Larkin & Associates, PLLC, ("Larkin") is a Certified Public Accounting and Regulatory Consulting Firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). Larkin has extensive experience in the utility regulatory field as expert witnesses in over 600 regulatory proceedings, including numerous electric, water and wastewater, gas and telephone utility cases.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION?

A. Yes, I have testified before the Florida Public Service Commission ("FPSC" or "Commission") previously. I have also testified before several other state regulatory commissions.

Q. HAVE YOU PREPARED AN EXHIBIT DESCRIBING YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached Exhibit RCS-1, which is a summary of my regulatory experience and qualifications.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. Larkin & Associates, PLLC, was retained by the Florida Office of Public Counsel ("OPC") to review the rate request of Florida Public Utilities Company ("FPUC" or "Company"). Accordingly, I am appearing on behalf of the Citizens of the State of Florida ("Citizens").

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I am presenting OPC's overall recommended revenue requirement in this case. I also sponsor some of the OPC's recommended adjustments to the Company's proposed rate base and operating income.

Q. WHAT EXHIBITS HAVE YOU ATTACHED TO YOUR TESTIMONY?

A. I have attached the following exhibits:

RCS-1, Qualifications Appendix; and

RCS-2, Revenue Requirement and Adjustment Schedules for projected 2023 Test Year.

Q. ARE ANY ADDITIONAL WITNESSES APPEARING ON BEHALF OF THE FLORIDA OFFICE OF PUBLIC COUNSEL IN THIS CASE?

A. Yes. David Garrett addresses FPUC's recommended capital structure and return on equity ("ROE") as well as the Company's proposed depreciation rates.

II. FPUC REQUESTED REVENUE INCREASE

Q. WHAT IS THE COMPANY REQUESTING IN THIS PROCEEDING?

A. The Company is requesting an increase to it base rates of $43.82 million, which is based on a projected test year ending December 31, 2023. Of this amount, $19.76 million is related to the Company's proposal to move its investments in its Gas Reliability Infrastructure Program ("GRIP") into rate base and resetting the GRIP surcharge to zero pursuant to Order No. PSC-2012-0490-TRF-GU, issued September 24, 2012, in Docket No. 20120036-GU. The remaining $24.06 million being requested by FPUC is, according to the Company, necessary to allow FPUC to earn a fair return on its investment. FPUC's request, net of the GRIP investment, reflects an overall increase of approximately 29%.

The Company is proposing an ROE of 11.25% which generates an overall rate of return of 6.43%. OPC's recommended ROE and rate of return is addressed by OPC witness David Garrett.

III. ORGANIZATION OF TESTIMONY

Q. HOW ARE THE DISCUSSIONS THAT ARE BEING ADDRESSED IN YOUR TESTIMONY ORGANIZED?

A. As noted above, in Section II, I have briefly summarized FPUC's requested revenue increase.

The remainder of my testimony is organized as follows:

In Section IV, I present the overall financial summary schedules for the base rate change to be effective January 1, 2023, showing the revenue requirement excess for the projected 2023 test year that I am recommending. Exhibit RCS-2 presents the schedules and calculations in support of the projected 2023 base rate revenue requirement.

In Section V, I then discuss my proposed adjustments which impact the January 2023 Base Rates, including how the new depreciation rates (and resulting expense and capital structure impacts) recommended by Witness Garrett have been reflected.

IV. OVERALL FINANCIAL SUMMARY SCHEDULES – JANUARY 2023 BASE RATE CHANGE

Q. WHAT IS THE JANUARY 2023 BASE RATE REVENUE REQUIREMENT DEFICIENCY OR EXCESS FOR FPUC?

A. As shown on Exhibit RCS-2, Schedule A, the OPC's recommended adjustments in this case result in a recommendation that FPUC not be authorized a revenue increase in January 2023 of any more than approximately $7.75 million exclusive of the GRIP revenue requirement transfer into base rates. This is $16.31 million less than the base rate revenue increase of $24.06 million (exclusive of the GRIP investments) requested by FPUC in its Petition.

Q. PLEASE DISCUSS THE EXHIBIT YOU PREPARED IN SUPPORT OF YOUR TESTIMONY AS IT PERTAINS TO THE JANUARY 2023 BASE RATE CHANGE.

A. Exhibit RCS-2 consists of Summary Schedules A, A-1, B, B.1, C, C.1 and D and Adjustment Schedules B-1 through B-6 and C-1 through C-12.

Q. WHAT IS SHOWN ON SCHEDULE A, PAGE 1, OF EXHIBIT RCS-2?

A. Schedule A, page 1, presents the maximum revenue requirement calculation for the January 2023 Base Rate change, giving effect to all of the adjustments I am recommending in this testimony, along with the impacts of the recommendations made by OPC Witness Garrett.

Q. WHAT IS SHOWN ON SCHEDULE A, PAGE 2, OF EXHIBIT RCS-2?

A. Schedule A, page 2, presents a reconciliation of the revenue requirement showing the estimated impacts of OPC recommendations.

Q. WHAT IS SHOWN ON SCHEDULE A-1?

A. Schedule A-1 shows the gross revenue conversion factor ("GRCF"), which is used to convert net operating income into equivalent revenue requirement amounts. As shown there, FPUC's Petition used a GRCF, which the Company refers to as the Revenue Expansion Factor, of 1.34941. As shown on Schedule A-1, in column B, I have used FPUC's GRCF of 1.34941 in my revenue requirement calculations. My use of FPUC's GRCF of 1.34941 is also shown on Exhibit RCS-2, Schedule A, page 1, column B, line 7.

Q. WHAT IS SHOWN ON SCHEDULE B?

A. Schedule B presents OPC's adjusted rate base that incorporates each of the adjustments impacting rate base that are recommended by OPC Witnesses in this case.

Q. WHAT IS SHOWN ON SCHEDULE B.1?

A. Schedule B.1 presents each of the adjustments impacting rate base that are recommended by OPC Witnesses in this case.

Q. WHAT IS SHOWN ON SCHEDULE C OF EXHIBIT RCS-2?

A. OPC's adjusted net operating income is shown on Schedule C. This incorporates each of the adjustments impacting net operating income that are recommended by OPC Witnesses in this case. The OPC's adjusted results for net operating income are shown on Schedule C in column C.

Q. WHAT IS SHOWN ON SCHEDULE C.1 OF EXHIBIT RCS-2?

A. Schedule C.1 summarizes each of the adjustments impacting net operating income that are recommended by OPC Witnesses in this case.

Q. WOULD YOU PLEASE DISCUSS SCHEDULE D?

A. Schedule D presents OPC's recommended capital structure and overall rate of return, based on the long-term debt-to-equity ratio and ROE recommended by Witness Garrett. The capital structure ratios for debt and common equity are based on the ratios recommended by Mr. Garrett. On Schedule D, I have applied the adjustments to the capital structure necessary to synchronize OPC's recommended capital structure to the adjusted jurisdictional rate base. On Schedule D, I applied Mr. Garrett's recommended ROE, resulting in OPC's overall recommended rate of return of 5.20%.

V. RECOMMENDED ADJUSTMENTS TO RATE BASE AND NET OPERATING INCOME

Q. WOULD YOU PLEASE DISCUSS EACH OF THE ADJUSTMENTS THAT YOU, AND OPC WITNESS GARRETT, ARE RECOMMENDING THAT AFFECT THE RATE BASE AND NET OPERATING INCOME IN FPUC'S FILING?

A. Yes, I will address each adjustment below.

A. RATE BASE ADJUSTMENTS

Q. ON WHAT SCHEDULES IN EXHIBIT RCS-2 DO YOU SHOW RATE BASE ADJUSTMENTS?

A. Exhibit RCS-2 shows rate base adjustments for the 2023 projected test year on Schedules B-1 through B-6.

Miscellaneous Intangible Plant

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO MISCELLANEOUS INTANGIBLE PLANT.

A. In its response to OPC Interrogatory No. 119, the Company stated that its miscellaneous plant balance was reflected on FPUC's books prior to its acquisition by Chesapeake Utilities Corporation ("CUC") in October 2009. In addition, the Company stated that a review of its plant records from 2009 and 1998 revealed that its miscellaneous plant balances related to rights granted for the Wayside and Deland South natural gas stations were reclassified from plant account 379 to 303 and that these assets were last amortized for four months in 2011. FPUC stated that it should have continued recording amortization entries until these assets were fully amortized and that it will make a true-up amortization entry to correct this error. The Company stated that its projected average rate base will be $85,839 lower as a result of making this correction.

As shown on Exhibit RCS-2, Schedule B-1, I have reduced FPUC's plant in service by the $85,839 identified above by FPUC.

Directors and Officers Liability Insurance Expense in Working Capital

Q. PLEASE EXPLAIN THE ADJUSTMENT FOR DIRECTORS AND OFFICERS LIABILITY EXPENSE INCLUDED IN WORKING CAPITAL.

A. For the reasons discussed in a later section of my testimony as it relates to the operating income adjustment shown on Exhibit RCS-2, Schedule C-7, this adjustment reduces Directors and Officers Liability ("D&O") liability insurance expense included in working capital to reflect an allocation to shareholders for half of the cost of the prepaid D&O insurance. D&O liability insurance protects shareholders from the decisions they made when they hired the Company's Board of Directors and the Board of Directors in turn hired the executive officers of the Company. There is no question that D&O liability insurance, which FPUC has elected to purchase, is primarily for the benefit of shareholders. Since shareholders are the primary beneficiary, they should be responsible for at least some of the costs associated with acquiring this coverage. Thus, as it applies to rate base and as shown on Exhibit RCS-2, Schedule B-2, my recommendation is to remove one half of D&O insurance expense from working capital which reduces projected 2023 test year rate base by $18,049.

Accumulated Depreciation - New Depreciation Rates

Q. PLEASE EXPLAIN THE ADJUSTMENT TO ACCUMULATED DEPRECIATION EXPENSE FOR NEW DEPRECIATION RATES.

A. As shown on Exhibit RCS-2, Schedule B-3, average rate base for the 2023 projected test year is increased by $928,851 for the impact of the new depreciation rates being recommended by Witness Garrett. His recommendation for new depreciation rates results in lower 2023 depreciation expense than FPUC's proposal. Thus, a lower amount of average 2023 accumulated depreciation results from his depreciation rate recommendation. The 2023 rate base impact was calculated by calculating a 13-month average of Mr. Garrett's depreciation expense impact. The impact of Mr. Garrett's recommendation on 2023 depreciation expense is discussed further in conjunction with the related adjustment to operating expense.

<u>Unamortized Rate Case Expense</u>

Q. PLEASE EXPLAIN THE COMPANY'S ADJUSTMENT TO RATE CASE EXPENSE.

A. As discussed in the direct testimony of Company witness Cassel, FPUC has estimated rate case expenses totaling $3,427,574 million, which it proposes to amortize over a five-year period. As shown on MFR Schedule C-13, using the five-year amortization period, FPUC proposes to include $685,515 for the projected 2023 test year rate case expense amortization.

Q. HAS THE COMPANY INCLUDED THE PROJECTED TEST YEAR BALANCE OF UNAMORTIZED RATE CASE EXPENSE IN ITS WORKING CAPITAL REQUEST IN THIS CASE?

A. Yes. As noted above, the working capital component of rate base for the projected 2023 test year includes $3,427,574 for FPUC's projected unamortized rate case expense associated with this case. In its response to OPC Interrogatory No. 63(d), FPUC stated that it included one-half of the $3,427,574 of estimated rate case expense in the working capital component of its projected 2023 test year rate base. However, in its response to OPC

Interrogatory No. 139(b), the Company stated that the amount of rate case expense included in the working capital component of rate base in its original filing is $1,871,956, which reflects one-half of $3,743,911 as shown on MFR Schedule G-1, page 5. The response to OPC Interrogatory No. 139(b) states that the corrected rate base amount should be one-half of the aforementioned $3,427,574, or $1,713,787, resulting in a difference of $158,169 (1,871,956 - $1,713,787) between the Company's original filing and its corrected amount.

Q. NOTWITHSTANDING THE COMPUTATIONAL ERROR IN FPUC'S WORKING CAPITAL CALCULATION, SHOULD FPUC BE PERMITTED TO INCLUDE IN RATE BASE THE UNAMORTIZED RATE CASE EXPENSE BALANCE?

A. No, it should not. The Commission has disallowed the inclusion of unamortized rate case expense in working capital within several prior decisions. This long-standing Commission policy was reaffirmed in Order No. PSC-2010-0131-FOF-EI, issued March 5, 2010, involving Progress Energy Florida. At pages 71 - 72 of that Order, the Commission stated the following with regard to unamortized rate case expense:

> We have a long-standing policy in electric and gas rate cases of excluding unamortized rate expense from working capital, as demonstrated in a number of prior cases. The rationale for this position was that ratepayers and shareholders should share the cost of a rate case: i.e., the cost of the rate case would be included in the O&M expenses, but the unamortized portion would be removed from working capital. It espouses the belief that customers should not be required to pay a return on funds expended to increase their rates.
>
> While this is the approach that has been used in electric and gas cases, water and wastewater cases have included unamortized rate case expense in working capital. The difference stems from a statutory requirement that water and wastewater rates be reduced at the end of the amortization period (Section 367.0816, F.S.). While unamortized rate case expense is not allowed to earn a return in working capital for electric and gas companies, it is offset by the fact that rates are not reduced after the amortization period ends.

> We agree with the long-standing policy that the cost of the rate case should be shared, and therefore find that the unamortized rate case expense amount of $2,787,000 shall be removed from working capital. (footnote omitted)

In a footnote on page 71 of the Order, the Commission identified the following cases that confirm and validate its long-standing policy of excluding the unamortized rate case expense from working capital in electric and gas cases:

> Order No. 23573, issued October 3, 1990, in Docket No. 891345-EI, In re: Application of Gulf Power Company for a rate increase; Order No. PSC-09-0283-FOF-EI, issued April 30, 2009, in Docket No. 080317-EI, In re: Petition for rate increase by Tampa Electric Company; Order No. PSC-09-0375-PAA-GU, issued May 27, 2009, in Docket No. PSC-09-0375-PAA-GU, In re: Petition for rate increase by Florida Public Utilities Company.

In addition, in Order No. PSC-2010-0153-FOF-EI, which was issued March 17, 2020, pursuant to FPL's rate case in Docket No. 20080677-EI, at page 164, the Commission stated in part:

> We do not agree with the Company that the unamortized balance of rate case expense should be included in rate base. Historically, the unamortized balance of rate case expense has been excluded from rate base to reflect a sharing of the rate case cost between the ratepayers and the shareholders. Rate case expenses are recovered from ratepayers through the amortization process as a cost of doing business in a regulated environment. However, the unamortized balance of rate case expense has been excluded from rate base to reflect that an increase in rates is a benefit to the shareholders. (footnote omitted)

This policy was also affirmed in Commission Order No. PSC-2012-0179-FOF-EI, issued April 3, 2012, in Docket No. 20110138-EI, involving Gulf Power Company, where the Commission stated at pages 30 and 31:

> [W]e have a long-standing practice in electric and gas rate cases of excluding unamortized rate case expense from working capital, as demonstrated in a number of prior cases. The rationale for this position is that ratepayers and shareholders should share the cost of a rate case; i.e., the cost of the rate case would be included in O&M expense, but the

> unamortized portion would be removed from working capital. This practice underscores the belief that customers should not be required to pay a return on funds spent to increase their rates.
>
> * * *
>
> For the foregoing reasons, we find that the unamortized rate case expense of $2,450,000 shall be removed from working capital consistent with our long-standing practice. (footnote omitted)

In a footnote on page 30 of the Gulf Power Order, the Commission identified the same cases referenced in the footnote of the Progress Energy Florida Order discussed above.

Q. DO YOU RECOMMEND THAT THE UNAMORTIZED RATE CASE EXPENSE BE EXCLUDED FROM RATE BASE IN THIS CASE?

A. Yes. In its direct case the Company failed to provide any justification for overturning a long-standing Commission policy and, thus, has not met its burden of proof. I recommend that the Commission follow its long-standing policy of not allowing inclusion of the unamortized rate case expense in rate base. Consistent with the Commission's findings in the Progress Energy Florida base rate case, the Gulf Power Company base rate case, and FPL's 2010 base rate case, it would be unfair for customers to pay a return on the costs incurred by the Company in this case when these are being used to increase customer rates. I have reflected a two-part adjustment, including (1) the $158,169 error correction discussed above, and (2) removing the Company's updated remaining amount for the unamortized balance of rate case expense from working capital (i.e., $1,713,787), thus reducing rate base by $1,871,956, as shown on Exhibit RCS-2, Schedule B-4.

<u>Accumulated Depreciation – Area Expansion Program</u>

Q. PLEASE EXPLAIN YOUR ADJUSTMENT SHOWN ON SCHEDULE B-5.

A. In its response to Staff Interrogatory No. 7(b), the Company stated that its projected 2023 test year includes plant investment and a reserve adjustment of $4.081 million and $0, respectively, which relate to modifications made to FPUC's Area Expansion Program ("AEP"). The response to Staff Interrogatory No. 7(b) states that the reserve adjustment was understated and should have included a projected adjustment in the credit amount of $85,698.

As shown on Exhibit RCS-2, Schedule B-5, I have increased FPUC's accumulated depreciation (thus decreasing rate base) by that same $85,698 amount to reflect this correction.

FPUC Merger Acquisition Adjustment

Q. HAS FPUC INCLUDED AN ACQUISITION ADJUSTMENT RELATED TO THE MERGER OF FPUC WITH CHESAPEAKE UTILITIES CORPORATION IN ITS RATE BASE REQUEST?

A. Yes. As discussed in the Company's Petition, in Order No. PSC-2012-0010-PAA-GU, issued dated January 3, 2012, in Docket No. 20110133-GU, the Commission allowed CUC to record a $34,192,493 purchase price premium related to the acquisition of FPUC as a positive acquisition adjustment to be amortized over a 30-year period beginning in November 2009. As shown on MFR Schedule B-6 Consolidated (and also reflected on MFR Schedule G-1 Consolidated), FPUC included the $34,192,493 acquisition adjustment (net of accumulated amortization) in its projected 2023 test year average rate base.

As stated in FPUC's Petition, this acquisition adjustment is discussed in the direct testimonies of Company witnesses Cassel, Napier and Deason.

Q. DID COMMISSION ORDER NO. PSC-2012-0010-PAA-GU AUTHORIZE RATE RECOVERY FOR THE FPUC MERGER ACQUISITION ADJUSTMENT?

A. No. On page 17 of Order No. PSC-2012-0010-PAA-GU, the Commission ordered that:

> …the level of the cost savings supporting Chesapeake Utilities Corporation's request shall be subject to review in Florida Public Utilities Company's next rate proceeding. In FPUC's next rate proceeding, if it is determined that the cost savings no longer exist, the acquisition adjustment may be partially or totally removed as deemed appropriate by us.

Q. WHAT IS FPUC REQUESTING WITH REGARD TO THE FPUC MERGER ACQUISITION ADJUSTMENT?

A. As stated on page 26 of the Direct Testimony of Company witness Napier, FPUC is requesting that the Commission approve the following with regard to this acquisition adjustment:

- Allow the Company to retain and recover the unamortized acquisition adjustment;
- Continue amortization of the acquisition adjustment over the approved period of time remaining; and
- Remove the requirement to re-evaluate cost savings in order to keep the acquisition adjustments.

Q. WHAT ARE SOME OF THE FUNDAMENTAL CONCERNS THAT SHOULD BE CONSIDERED BY THE COMMISSION IN ADDRESSING THE RATEMAKING TREATMENT FOR THIS LARGE POSITIVE AQUISITION ADJUSTMENT?

A. While CUC's acquisition of the FPUC system may have been between a willing buyer and willing seller, there is more to consider on whether the purchase price was established through an arm's-length negotiation. In these situations involving the sale of a regulated public utility, the buyer and seller can both have a common interest in having a high price for the system. The seller is seeking the highest price. The investor-owned acquirer purchases a utility system into which it can invest and increase profits by making investments into the utility's rate base. However, unlike a non-regulated business acquisition, for a rate regulated public utility, the acquiring entity can also request to include the acquisition cost in rate base, and, if the acquisition premium is included in rate base, the buyer can earn even more profits. Because both the seller and buyer have incentives to drive up the purchase price for the utility system, this type of purchase is different than other types of arm's length transactions, which would normally involve a seller trying to get a high price and an independent buyer trying to get a low price. Here, where the acquisition of a rate regulated gas distribution utility is involved, both the seller and the buyer have incentives related to having a high price that exceeds the net book value of the utility. This incentive also involves the creation of an acquisition premium that the buyer could request be included in rate base, in addition to the post acquisition investments that the buyer makes to utility plant. Without a demonstration that continued, ongoing costs savings above the annualized acquisition amount are being realized, the potential harm to customers from unnecessarily higher rates due to evaporated merger savings is too great. The Company has failed to meet its burden of proof to demonstrate that the cost savings developed as it predicted, or that the cost savings persist now, and will do so in the future when new rates will be in effect.

Q. YOU NOTED ABOVE THAT THE COMMISSION'S ORDER NO. PSC-2012-010-PAA-GU STATED THAT FPUC'S LEVEL OF COST SAVINGS RELATED TO THE FPUC MERGER ACQUISITION ADJUSTMENT IS SUBJECT TO REVIEW IN FPUC'S NEXT RATE PROCEEDING. IS FPUC ASSERTING THAT COST SAVINGS RELATED TO THE ACQUISITION STILL EXISTS?

A. Yes. On page 27 of her Direct Testimony, Company witness Napier states that the Companies have maintained a level of cost savings that is consistent with what was approved in the Commission's Order.

Q. IS THE COMPANY RELYING ON ANY OTHER CRITERIA TO SUPPORT ITS REQUEST TO INCLUDE THE FPUC MERGER ACQUISITION ADJUSTMENT IN ITS PROJECTED 2023 TEST YEAR RATE BASE?

A. Yes. As discussed in the direct testimonies of Company witnesses Cassel and Deason, the Company is relying on five factors that the Commission discussed in Order No. PSC-2012-0010-PAA-GU when it approved the FPUC merger acquisition adjustment. These five factors are as follows: (1) increased quality of service; (2) lower operating costs; (3) increased ability to attract capital for improvements; (4) lower overall cost of capital; and (5) more professional and experienced managerial, financial, technical and operational resources.[1]

Q. DO YOU AGREE WITH FPUC'S REQUEST TO INCLUDE THE UNAMORTIZED ACQUISITION ADJUSTMENT RELATED TO THE FPUC MERGER IN ITS PROJECTED 2023 TEST YEAR RATE BASE?

A. No, I do not agree with FPUC's request to include the unamortized acquisition adjustment related to the FPUC merger in its projected 2023 test year rate base. FPUC has failed to carry its burden of demonstrating that the recognition of the adjustment should be

[1] See Order No. 23376, issued August 21, 1990, in Docket No. 891309-WS, In re: Investigation of Acquisition Adjustment Policy; Order No. 23858, issued December 11, 1990, in Docket No. 891353-GU, In re: Application of Peoples Gas Systems, Inc. for a rate increase; and Order No. PSC-04-1110-PAA-GU, issued November 8, 2004, in Docket 040216-GU, In re: Application for rate increase by Florida Public Utilities Company.

continued. I recommend that the Company's proposal to charge ratepayers for that acquisition adjustment should be rejected.

Q. PLEASE EXPLAIN WHY THE COMPANY'S REQUEST FOR RATE INCLUSION OF THE FPUC MERGER ACQUISITION ADJUSTMENT SHOULD BE REJECTED.

A. The application of the five factors noted above to the CUC acquisition of FPUC's gas distribution utility demonstrates that the five standards that the Commission has identified for review of utility-proposed acquisition adjustments have not been fully satisfied. The utility bears the burden of proof in satisfying all five criteria. Merely suggesting that these criteria are met is not sufficient proof. The Company has failed to demonstrate that the acquisition by CUC of the FPUC gas distribution utility fully meets all five criteria. Consequently, the unamortized portion of the acquisition adjustment should be excluded from rate base.

Q. HAS THE COMPANY DEMONSTRATED THAT THE SYSTEM IMPROVEMENTS TO INCREASE THE QUALITY OF SERVICE ARE ATTRIBUTABLE TO THE ACQUISITION BY CUC?

A. No. As would be expected, normal improvements have been made, subsequent to the merger, that involve investments in utility plant that are included in rate base and allowed to earn a return for the Company. There is nothing special or extraordinary about this. FPUC has not carried its burden to demonstrate that these investments have been made as a consequence of the merger, as opposed to other business reasons. For example, due to the required GRIP program implemented to meet federal safety requirements, significant infrastructure has been replaced and recorded as plant in service.

Q. HAS THE COMPANY DEMONSTRATED THAT THE PORTION OF ITS REQUESTED RATE INCREASE THAT IS RELATED TO THE RECOVERY OF THE ACQUISITION PREMIUM WILL NOT HARM CUSTOMERS?

A. No. Given the overall post-merger costs and rate impacts that the Company is requesting to recover from customers, the Company has not carried its burden to demonstrate that its requested rate increase will not cost customers more, particularly if the acquisition adjustment is allowed to be included in utility rate base in this rate case. The large rate increases being sought in the current rate case are indicators that customers would be adversely impacted if the acquisition adjustment is allowed to be included in rate base.

Q. WAS THE COMPANY REQUIRED TO DEMONSTRATE LOWER OPERATIONAL COST SAVINGS IN ITS ORIGINAL REQUEST TO OBTAIN APPROVAL OF THE ACCOUNTING TREATEMENT AND AMORTIZATION OF THE POSITIVE AQUISTION ADJUSTMENT?

A. Yes, in receiving approval in 2012 for CUC's acquisition of FPUC, the Company had to prove the operational cost savings. In Order No. PSC-2012-0010-PAA-GU, issued January 3, 2012, in Docket No. 20110133-GU at page 6, the Company asserted that there would be lower operational costs for the following:

Total Net Operating Cost Savings

Cost Savings – Capacity		$941,266
Cost Savings – Cost of Capital		330,124
Cost Savings – Personnel Related		5,425,590
Cost Savings – Corporate		1,116,870
Cost Increases – Personnel Related		(982,707)
Cost Increases – Corporate & Benefits		(575,956)
TOTAL Net Operating Cost Savings		$6,255,187

Q. HAS THE COMPANY PROVIDED SIMILAR PROOF OF ONGOING LOWER OPERATIONAL COST SAVINGS CONTINUING IN THIS CASE THROUGH THE PROJECTED 2023 TEST YEAR?

A. No. It is not clear whether any substantial operational economies have been achieved through the acquisition that can be attributed to CUC's ownership of the FPUC gas distribution utility. The Company has added employees since the acquisition and has updated some systems but has not convincingly met its burden to demonstrate that significant operational economies have been achieved and maintained through the acquisition and under CUC's ownership. Moreover, there does not appear to be an overall financial and service benefit to customers from the utility's operations under CUC's ownership. Although the acquisition resulted in more customers to share utility expenses, it appears that the cost to provide service has increased significantly, as evidenced by the large rate increase being sought in the current rate case. Ratepayers should not be required to pay higher rates attributable to an acquisition premium paid to acquire other systems.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE RATE BASE TREATMENT FOR THE POSITIVE FPUC MERGER ACQUISITION ADJUSTMENT IN THIS CASE?

A. CUC's acquisition of the FPUC gas distribution utility system does not continue to meet all five standards set forth above; therefore, the Company should not be allowed to recover its requested premium for the acquisition. Specifically, the Company failed to prove that lower costs savings, improved quality of service, and financial benefits exists solely from the acquisition. Without the inclusion of the FPUC merger acquisition adjustment in rate base, the base rate revenue increase requested by the Company would be reduced by approximately $1.307 million (at the OPC's proposed cost of capital). Additionally, if the related acquisition adjustment amortization is rejected for inclusion in 2023 projected test year operating expenses, the Company's requested revenue requirement should be reduced by approximately $1.148 million.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATION FOR THE FPUC MERGER ACQUISITION ADJUSTMENT.

A. The acquisition adjustment should not be allowed to be included in rate base, and the related amortization expense should not be allowed to be included in 2023 test year operating expenses.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT.

A. As shown on Exhibit RCS-2, Schedule B-6, I have removed the FPUC merger acquisition adjustment of $34,192,493 from FPUC's projected 2023 test year average rate base. In addition, I have removed the related accumulated amortization impact on the projected 2023 average test year rate base. As shown on Schedule B-6, I started with the accumulated amortization balance as of December 31, 2021 (from MFR Schedule B-6 Consolidated, page 3 of 3) and then carried out the monthly amortization to December 31, 2023. I then calculated the 13-month average using the period December 31, 2022 through December 31, 2023 to derive the average 2023 test year accumulated amortization amount of $15,576,577. I netted that $15,576,577 against the $34,192,493 to derive a net adjustment to decrease the Company's requested average rate base by $18,615,916.

Q. IS THERE A RELATED ADJUSTMENT FOR AMORTIZATION EXPENSE?

A. Yes. As discussed in a later section of my testimony, there is a related amortization expense adjustment, which is shown on Exhibit RCS-2, Schedule C-13.

Indiantown Acquisition Adjustment

Q. HAS THE COMPANY INCLUDED ANOTHER ACQUISITION ADJUSTMENT IN ITS APPLICATION?

A. Yes. As discussed on page 12 of the Company's Application, in Order No. PSC-2014-0015-PAA-GU, issued dated January 6, 2014, in Docket No. 20120311-GU, the Commission allowed FPUC to record a $745,800 purchase price premium related to the acquisition of Indiantown Gas Company ("Indiantown") as a positive acquisition adjustment to be amortized over a 15-year period beginning on August 1, 2010. However, I am only addressing the FPUC merger acquisition adjustment.

Q. IS THERE A REASON THAT YOU ARE ONLY ADDRESSING THE FPUC MERGER ACQUISITION ADJUSTMENT?

A. Yes. While some of the concerns regarding the FPUC merger acquisition adjustment are also applicable to the Indiantown acquisition premium, the Indiantown acquisition adjustment is substantially smaller for a company the size of FPUC and thus, has a much smaller impact on the Company's requested rate increase. In addition, the Company has been amortizing the Indiantown acquisition adjustment since August 1, 2010, in accordance with Order No. PSC-2014-0015-PAA-GU. It is expected to be fully amortized by July 31, 2025. The projected 2023 test year amounts are shown in the table below:

Description	Amount
Acquisition Adjustment Related to Indiantown Gas Company	$ 745,800
13-Month Average Accumulated Amortization Related to Indiantown Gas Company Acquisition Adjustment	$ (642,217)
Net Amount of Indiantown Gas Company Acquisition Adjustment in Projected Test Year Average Rate Base	$ 103,583
Annual Amortization Expense Related to the Indiantown Gas Company Acquisition Adjustment	$ 49,720

In addition, as shown in the above table, the annual amortization expense is only $49,720, and the 2023 rate base amount is $103,583.

B. NET OPERATING INCOME ADJUSTMENTS

Q. ON WHAT SCHEDULES DO YOU PRESENT NET OPERATING INCOME ADJUSTMENTS?

A. On Exhibit RCS-2, for the 2023 projected test year, adjustments to operating expenses that affect net operating income are presented on Schedules C-1 through C-12.

Depreciation Expense - New Depreciation Rates

Q. PLEASE EXPLAIN THE ADJUSTMENT TO DEPRECIATION EXPENSE FOR NEW DEPRECIATION RATES.

A. The amounts on Exhibit RCS-2, Schedule C-1, page 4 in column A, were supplied to me by Witness Garrett, who is recommending new depreciation rates that differ from those proposed by FPUC. FPUC's proposed depreciation rates applied to FPUC's projected 2023 test year Plant produces annual depreciation expense accruals of approximately $14.56 million, as summarized in column A, line 1 of Schedule C-1, page 1. In comparison, Mr. Garrett's recommended new depreciation rates produce annual depreciation accruals of approximately $12.36 million, as summarized on Schedule C-1, page 1 in column B, line 1. As shown on Schedule C-1, page 1, column C, Mr. Garrett's recommended new depreciation rates for FPUC results in annual depreciation expense for 2023 that is $2.205 million less than the annual depreciation accruals computed using FPUC's depreciation rates. As shown on Exhibit RCS-2, Schedule C-1, page 1, column C and page 5, column M, depreciation expense is reduced by $2.205 million to reflect the depreciation rates being recommended by OPC witness Garrett.

Q. IS THERE A CORRESPONDING RATE BASE ADJUSTMENT RELATED TO THE ADJUSTMENT FOR THE NEW DEPRECIATION RATES FOR FPUC?

A. Yes. As shown on Exhibit RCS-2, Schedule B-3 and discussed above in conjunction with rate base adjustments, there is a related adjustment which decreases accumulated depreciation (and increases rate base). The impacts on 2023 average rate base were derived by calculating a 13-month average of the depreciation expense adjustment that is shown on Schedule C-1, page 5.

<u>Amortization Expense Related to FPUC Merger Acquisition Adjustment</u>

Q. PLEASE EXPLAIN YOUR ADJUSTMENT ON SCHEDULE C-2.

A. As discussed previously in my testimony, I am recommending that the FPUC merger related acquisition adjustment (and related accumulated amortization) be removed from projected 2023 test year rate base. Pursuant to that adjustment, I am also removing the related amortization expense from projected 2023 test year cost of service.

As shown on Exhibit RCS-2, Schedule C-2, my recommended adjustment reduces amortization expense by $1,139,750.

<u>Incentive Compensation Expense</u>

Q. DOES THE COMPANY HAVE AN INCENTIVE COMPENSATION PLAN AVAILABLE TO ITS EMPLOYEES?

A. Yes. The Company has an incentive performance plan ("IPP") available to its employees. FPUC provided a copy of (1) Florida Public Utilities 2019 Incentive Performance Plan – Florida, and (2) CUC and all Business Units/Verticals Incentive Performance Plan (i.e., 2021 Incentive Performance Plan) in its response to OPC Interrogatory No. 38. In this response, the Company stated that the 2021 IPP (i.e., enterprise wide plan) was used for 2021. I used the 2021 IPP plan as the basis for my analysis, as it is the most recent plan.

Q. WHAT ARE THE IPP PLAN'S STATED PRIMARY OBJECTIVES?

A. The stated primary objectives of FPUC's IPP plan are to:

- Reward each employee's individual contribution to the overall performance results consistent with their eligibility.
- Create alignment and link performance metrics related to CUC's and Business Units ("BU")/Vertical strategy, operational objectives and financial targets to individual compensation.
- Create a line of sight for each employee to clearly understand how their performance contributes to the overall success of the Company.
- Recognize and reward performance achievement of departmental/team goals and metrics.

Q. PLEASE BRIEFLY DESCRIBE THE IPP PLAN.

A. As discussed in the 2021 IPP, CUC and all subsidiary business units provide an annual incentive performance plan for non-officer, eligible employees. Under the IPP, eligible employees have the opportunity to earn an annual cash bonus/incentive. In addition, the IPP has the following four performance categories:

1) The Individual's Performance Rating (PR) annual score.
2) Chesapeake Corporate Earnings Per Share (EPS) overall annual results.
3) Consolidated Return on Equity (ROE).
4) Identified Non-Financial goals, including (1) Safety for 2021, and (2) add other non-financial goals each year such as Equity, Diversity and Inclusion; Net Promoter; Engagement; etc.

Q. HAS FPUC INCLUDED INCENTIVE COMPENSATION EXPENSE IN ITS PROJECTED 2023 TEST YEAR COST OF SERVICE?

A. Yes. The response to OPC Interrogatory No. 42 indicates that the Company has included incentive compensation expense totaling $2,180,201 in the projected 2023 test year. Of this amount, $1,242,623 is for non-executives and $937,578 is for executives of the Company.

Q. ARE YOU RECOMMENDING AN ADJUSTMENT TO THE LEVEL OF INCENTIVE COMPENSATION THAT IS INCLUDED IN FPUC'S PROJECTED 2023 TEST YEAR COST OF SERVICE?

A. Yes. I recommend that 50% of the incentive compensation included in the projected 2023 test year be charged to shareholders. Specifically, my recommended 50% disallowance includes (1) 25% related to CUC's EPS performance category, and (2) 25% related to the Consolidated ROE category. The percentages for these two categories were informed by the IPP Payout Opportunity that is shown on page 3 of the IPP Plan document and replicated in the table below:

Target Bonus Opportunity %	Individual Performance	Corporate EPS	Consolidated ROE	Non-Financials (i.e., Safety)
20%	25%	30%	25%	20%
15%	30%	**25%**	**25%**	20%
12%	30%	20%	30%	20%
10%	40%	10%	30%	20%
7.50% - 8.50%	50%	10%	20%	20%
6%	50%	10%	20%	20%
Source: 2021 Incentive Performance Plan				

As shown in bold in the above table, the 25% Corporate EPS and 25% Consolidated ROE performance categories were included under the 15% Target Bonus Opportunity.

Q. PLEASE EXPLAIN THE REASON FOR REMOVING 50% OF INCENTIVE COMPENSATION EXPENSE?

A. In general, incentive compensation programs can provide benefits to both shareholders and ratepayers. The removal of 50% of the incentive compensation expense, in essence, provides an equal sharing of such cost, and therefore provides an appropriate balance between the benefits attained by both shareholders and ratepayers. Both shareholders and ratepayers stand to benefit from the achievement of performance goals. Shareholders are the primary beneficiary of achieving goals related to corporate earnings per share and consolidated return on equity. Moreover, there is no assurance that the award levels included in the Company's proposed or OPC's recommended incentive compensation expense (before sharing) will be continued in future years.

Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT FOR FPUC'S INCENTIVE COMPENSATION EXPENSE.

A. As shown on Exhibit RCS-2, Schedule C-3, this adjustment decreases projected 2023 test year expense by $1,090,101 to reflect the removal of 50% of the incentive compensation.

Q. IS THERE A RELATED ADJUSTMENT TO PAYROLL TAX EXPENSE?

A. Yes. As discussed below, my recommended adjustment to incentive compensation expense results in a related adjustment to payroll tax expense as shown on Exhibit RCS-2, Schedule C-5.

Stock-Based Compensation Expense

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO STOCK-BASED COMPENSATION EXPENSE.

A. As shown on Exhibit RCS-2, Schedule C-4, I have removed all stock-based compensation expense. Specifically, this adjustment decreases FPUC's projected 2023 test year cost of service by $1.376 million.

Q. WHAT TYPE OF STOCK-BASED COMPENSATION COSTS DID FPUC INCLUDE IN ITS PROJECTED 2023 TEST YEAR COST OF SERVICE?

A. In its response to OPC Interrogatory No. 43(b), FPUC stated that during the projected 2023 test year, the Company will incur common stock share-based compensation expense related to restricted stock units ("RSU") that were approved under the CUC 2013 Stock and Incentive Compensation Plan. Specifically, the response to OPC Interrogatory No. 43(b) states that the RSU's are issued to officers and executives of FPUC's parent company CUC. In addition, CUC issues stock-based compensation to members of its Board of Directors.

Q. DID THE COMPANY PROVIDE A COPY OF THE CUC 2013 STOCK AND INCENTIVE COMPENSATION PLAN DOCUMENTS?

A. Yes. In its response to OPC POD No. 59, the Company provided a copy of the CUC 2013 Stock and Incentive Compensation Plan.

Q. WHAT IS THE STATED PURPOSE OF THE CUC 2013 STOCK AND INCENTIVE COMPENSATION PLAN?

A. On page 55 of the CUC 2013 Stock and Incentive Compensation Plan, it states:

> The purpose of this Plan is to enhance shareholder value by linking the compensation of officers, directors and employees of the Company to **increases in the price of Chesapeake Utilities Corporation common stock** and the achievement of other performance objectives, and to encourage ownership in the Company by key personnel whose long-term employment is considered essential to the Company's continued progress and success. The Plan is also intended to assist the Company in the recruitment of new employees and to motivate, retain and encourage such employees and directors **to act in the shareholders' interest** and share in the Company's success.
>
> (Emphasis supplied)

Q. PLEASE DISCUSS THE REASONS FOR REMOVING STOCK-BASED COMPENSATION FROM FPUC'S PROJECTED 2023 TEST YEAR COST OF SERVICE.

A. Ratepayers should not be required to pay executive or management compensation that is based on the performance of the Company's (or its parent company's) stock price, or that has the primary purpose of benefitting the parent company's shareholders and aligning the interests of participants with those of such shareholders.

Charging a shareholder-oriented expense to FPUC's revenue requirement would not be good regulatory policy.

FPUC has failed to provide any studies that demonstrate a quantitative benefit to FPUC 's ratepayers from the provision of stock-based compensation directly charged to the Company and/or allocated to FPUC from CUC.

Additionally, prior to being required to expense stock options for financial reporting purposes under Statement of Financial Accounting Standards No. 123 Revised (SFAS 123R)[2], the cost of stock-option based compensation was typically treated as a dilution of shareholders' investments, i.e., it was a cost borne by shareholders. While

[2] This is now known as Accounting Standards Codification (ASC) 718.

SFAS 123R now requires stock-option based compensation cost to be expensed on a company's financial statements, this does not alter the rationale for not charging ratepayers, nor does it provide justification for shifting the cost responsibility for stock-based compensation from shareholders to utility ratepayers.

Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT FOR STOCK-BASED COMPENSATION EXPENSE.

A. As shown on Exhibit RCS-2, Schedule C-4, FPUC's projected 2023 test year cost of service is reduced by $1.376 million to remove stock-based compensation. This amount includes $169,107 that FPUC stated is to be provided to the Board of Directors of CUC.

Q. IS THERE A RELATED ADJUSTMENT TO PAYROLL TAX EXPENSE?

A. Yes. As discussed below, my recommended adjustment to stock-based compensation expense results in a related adjustment to payroll tax expense as shown on Exhibit RCS-2, Schedule C-5.

<u>Payroll Tax Expense</u>

Q. PLEASE EXPLAIN THE ADJUSTMENT TO PAYROLL TAX EXPENSE.

A. OPC's adjustment to the Company's payroll tax expense is made in conjunction with the adjustments that are being made to reduce incentive compensation and to remove stock-based compensation. Based upon those recommended adjustments, as shown on Exhibit RCS-2, Schedule C-5, payroll tax expense is reduced by **$175,682** ~~$188,619~~.

<u>Supplemental Executive Retirement Program (“SERP”) Expense</u>

Q. DOES FPUC’S PETITION CHARGE RATEPAYERS TOP EXECUTIVE COMPENSATION IN THE FORM OF EXPENSES FOR A SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN EXPENSE (“SERP”)?

A. Yes. FPUC’s response to OPC Interrogatory No. 46 shows that FPUC has reflected SERP expense in the projected 2023 test year in the amount of $1,762 in FERC account 920.

Q. CAN YOU PLEASE PROVIDE A GENERAL DESCRIPTION OF A SERP?

A. The SERP provides supplemental retirement benefits for select highly compensated executives. Generally, SERPs are implemented for executives to provide retirement benefits that exceed amounts limited in qualified plans by Internal Revenue Service (“IRS”) limitations. Companies usually maintain that providing such supplemental retirement benefits to executives is necessary in order to ensure attraction and retention of qualified employees. Typically, SERPs provide for retirement benefits in excess of the limits placed by IRS regulations on pension plan calculations for salaries in excess of specified amounts. IRS restrictions can also limit the Company 401(k) contributions such that the Company 401(k) contribution as a percent of salary may be smaller for a highly paid executive than for other employees.

Q. SHOULD THE SERP EXPENSE FOR FPUC EXECUTIVES BE BORNE BY FPUC’S RATEPAYERS?

A. No. The provision of additional compensation to FPUC’s highest paid current and former executives to remedy a perceived deficiency in retirement benefits relative to the Company’s other employees is not a reasonable expense that should be recovered in rates.

Without the SERP, the Company's and its affiliate's executive officers still enjoy the same retirement benefits available to any other FPUC employee and the attempt to make these executives "whole" in the sense of allowing a greater percentage of retirement benefits does not meet the test of reasonableness. If the Company wishes to provide additional retirement benefits above the level permitted by IRS regulations applicable to all other employees, it may do so at the expense of its shareholders. However, it is not reasonable to place this additional burden on ratepayers. The issue is not whether the utility may provide compensation to select executives in excess of the retirement limits allowed by the IRS, but whether ratepayers should be burdened with costs of executive benefits that exceed the treatment allowed for all other employees. If the Company chooses to do so, shareholders rather than ratepayers should be responsible for the retirement benefits afforded only to those executives.

Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT TO REMOVE THE SERP EXPENSE.

A. As shown on Exhibit RCS-2, Schedule C-6, the projected 2023 test year SERP expense amount identified by FPUC in its response to OPC Interrogatory No. 46 is being removed. This adjustment reduces FPUC's requested projected 2023 test year expense by $1,762.

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

Q. PLEASE EXPLAIN THE ADJUSTMENT FOR DIRECTORS AND OFFICERS LIABILITY EXPENSE.

A. This adjustment reduces Directors and Officers Liability ("D&O") liability insurance expense by the amount shown on Exhibit RCS-2, Schedule C-7, to reflect an allocation to shareholders for half of the cost of the prepaid D&O liability insurance. As noted earlier, D&O liability insurance protects shareholders from the decisions they made when they hired the Company's Board of Directors and the Board of Directors in turn hired the executive officers of the Company. There is no question that D&O liability insurance, which FPUC has elected to purchase, is primarily for the benefit of shareholders. Since shareholders are the primary beneficiary, they should be responsible for at least some of the costs associated with acquiring this coverage. The Company will inevitably argue that the cost is a necessary expense which protects ratepayers. Nevertheless, the cost of the premiums associated with acquiring D&O liability insurance, while considered to be a necessary business expense by many, is in reality a necessary business expense designed to protect shareholders from decisions made by the executive officers and board members who are elected by shareholders to represent shareholders. Notwithstanding that shareholders are the primary beneficiaries, I am recommending that this business expense be shared equally between shareholders and ratepayers.

Q. HAS THIS ISSUE IN PREVIOUS RATE CASES IN FLORIDA?

A. Yes. This issue was addressed in the 2011 Gulf Power Company rate case[3] In that case, the Commission determined that the cost for D&O liability insurance should be shared equally between shareholders and ratepayers. In the 2009 Progress Energy Florida ("PEF") case[4], the Commission allowed PEF to place one half the cost of D&O liability insurance in test year expenses noting that other jurisdictions make an adjustment for D&O liability insurance and that the Commission has disallowed D&O liability insurance in wastewater cases.

[3] See, Order No. PSC-2012-0179-FOF-EI, issued April 3, 2012, Docket No. 20110138-EI, In re: Petition for increase by Gulf Power Company, at p. 101.

[4] See, Order No. PSC-2010-0131-FOF-EI, issued March 5, 2010, in Docket No. 20090079-EI, In re: Petition for increase in rates by Progress Energy Florida, Inc. at p. 99.

Q. WHAT IF THE COMMISSION HAD NOT DISALLOWED HALF THE COST IN THE GULF AND PEF DOCKETS, WHAT WOULD YOU THEN RECOMMEND IN THIS CASE?

A. I would still be recommending to the Commission that there be either a complete disallowance or at the very least an equal sharing, because the cost associated with D&O liability insurance benefits shareholders first and foremost. Unlike an unregulated entity, criteria exist for recovery of costs, such as prudence and benefit. The benefit of D&O liability insurance is the protection shareholders receive from directors' and officers' imprudent decision making, which would be the subject of lawsuits brought by shareholders against the officers and directors. The benefit of this insurance clearly inures primarily to shareholders; some of whom generally are the parties initiating any suit against the directors and officers. The Commission's decisions on this question in the Gulf Power and PEF rate case dockets were fair, and those decisions should be followed in this Docket.

Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT.

A. As shown on Exhibit RCS-2, Schedule C-7, my adjustment to remove half of the cost of the D&O insurance reduces projected 2023 test year cost of service by $85,528.

Q. IS THERE ALSO AN ADJUSTMENT TO RATE BASE TO REFLECT THE REMOVAL OF HALF OF D&O INSURANCE FROM WORKING CAPITAL.

A. As shown on Exhibit RCS-2, Schedule B-2, there is a related adjustment which removes one half of the D&O insurance that FPUC included in its projected 2023 test year working capital.

Rent Expense

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO RENT EXPENSE.

A. OPC Interrogatory No. 113, which that FPUC identify each building, facility, or property it is renting along with the related annual rental cost of each item identified in the projected 2023 test year[5]. In an attachment provided with its response to that interrogatory, the Company included its Silver Lake facility, which reflected annual rent expense of $78,249 for the projected 2023 test year. However, Note 3 to that attachment stated: "This space is no longer leased. This was not known when the MFR schedules were prepared."

Since the Silver Lake facility is no longer being leased, as shown on Exhibit RCS-2, Schedule C-8, I have removed the rental expense of $78,249 from projected 2023 test year cost of service.

Lobbying Costs

Q. PLEASE EXPLAIN YOUR ADJUSTMENT ON SCHEDULE C-9.

A. In its response to OPC Interrogatory No. 54, the Company stated that its normal practice is to record all lobbying expenses to FERC account 426.4 (i.e., below the line), but that lobbying costs were inadvertently included in its cost of service for the following industry associations: (1) the American Gas Foundation, (2) Associated Gas Distributors of Florida, and (3) the American Gas Association. Lobbying cost totaling $35,366 was mistakenly included in the projected 2023 test year. In addition, in its response to OPC Interrogatory No. 138, the Company identified two invoices in the amounts of $109 and $6,406 that are related to lobbying expense that FPUC stated should be removed from the projected 2023 test year.

[5] OPC Interrogatory No. 113 also requested this information for calendar years 2019 through 2021, 2022 actuals through April and projected calendar year 2022.

As shown on Exhibit RCS-2, Schedule C-9, I have removed the lobbying costs that were inadvertently included in the projected 2023 test year, which reduces cost of service by $41,881.

Interest Synchronization

Q. WHAT IS THE PURPOSE OF YOUR 2023 TEST YEAR INTEREST SYNCHRONIZATION ADJUSTMENT ON EXHIBIT RCS-2, SCHEDULE C-10?

A. The interest synchronization adjustment allows the adjusted rate base and cost of debt to coincide with the income tax calculation. Since interest expense is deductible for income tax purposes, any revisions to the rate base or to the weighted cost of debt will impact the test year income tax expense related to the amount of the regulated utility's jurisdictional debt supporting the jurisdictional rate base. OPC's proposed rate base and weighted cost of debt differ from the Company's proposed amounts. Thus, OPC's recommended interest deduction for determining the 2023 test year income tax expense, related to this jurisdictional debt will differ from the interest deduction used by FPUC in its filing. Consequently, OPC's recommended debt ratio increase in this case will lead to a greater interest deduction in the income tax calculation, which, when applied to FPUC's adjusted rate base, results in a reduction to income tax expense in the amount of $134,104 as shown on Exhibit RCS-2, Schedule C-10.

Parent Company Debt Adjustment

Q. HAS THE COMPANY REDUCED INCOME TAX EXPENSE FOR THE IMPACT OF PARENT COMPANY DEBT?

A. No. Schedule G-2, page 29 of 31 has a line item (line 5) for a "Parent Debt Adjustment" but it shows a zero impact on income tax expense.

Q. IS AN ADJUSTMENT FOR THE EFFECT OF PARENT COMPANY DEBT ON INCOME TAXES REQUIRED BY FLORIDA RULES?

A. Yes. Specifically, Rule 25-14.004, F.A.C, "Effect of Parent Debt on Federal Corporate Income Tax" requires such an adjustment, absent the Company carrying its burden of rebutting that the jurisdictional equity is supported by debt on the parent's books.[6] The intent of Rule 25-14.004, F.A.C., is to require an adjustment to the income tax expense of a regulated company to reflect the income tax benefit of the parent debt that may have been invested as equity of the subsidiary.

Q. HAVE YOU CALCULATED THE IMPACT ON FEDERAL INCOME TAX EXPENSE FOR THE EFFECT OF PARENT DEBT ON FEDERAL CORPORATE INCOME TAX THAT IS REQUIRED BY RULE 25-14.004, F.A.C?

A. Yes. On Exhibit RCS-2, Schedule C-11, page 1, I have calculated an adjustment to reduce federal income tax expense by $679,973. To compute this adjustment, I multiplied the adjusted rate base for FPUC Consolidated Gas utility operations by the equity ratio to identify the amount of rate base that is financed with common equity. I then multiplied that by the CUC debt ratio of 41.5% which was provided to me by OPC witness David Garrett based on recent Value Line information. I then multiplied that result by CUC's cost of debt of 4.52% which was also provided to me by OPC witness David Garrett based on Value Line information. I then multiplied that amount of interest deduction by the federal income tax rate of 21% to determine the Effect of Parent Debt on Federal Corporate Income Tax that is required by Rule 25-14.004, F.A.C. As shown on Schedule C-11, page

[6] Subsection (3) of the rule provides: "It shall be a rebuttable presumption that a parent's investment in any subsidiary or in its own operations shall be considered to have been made in the same ratios as exist in the parent's overall capital structure."

1, this adjustment reduces federal income tax expense by $679,973. It should be noted that this adjustment should be made with information that is provided by the Company, including any additional "tiered" impacts based on ownership configuration within the entire affiliated corporate structure.[7]

Q. IS THE PARENT DEBT ADJUSTMENT SUBSUMED WITHIN THE INTEREST SYNCHONIZATION ADJUSTMENT?

A. No. Interest synchronization merely matches the interest deductible for calculating income tax expense to the debt portion of the regulated entity's capital structure that supports the reconciled rate base. It has nothing to do with the imputation of interest expense associated with the debt supporting the parent's investment in the equity of the regulated Company.

<u>Company Sponsored Events</u>

Q. PLEASE EXPLAIN YOUR ADJUSTMENT ON EXHIBIT RCS-2, SCHEDULE C-12.

A. In its response to OPC Interrogatory No. 101, the Company identified costs totaling $38,835 included in projected 2023 test year cost of service, which the Company described as Company events. Specifically, as stated in the referenced response, these costs relate to Company sponsored events and luncheons for team building and networking. I am removing these costs as they are not necessary for the provision of safe and reliable gas service to FPUC's ratepayers. As shown on Exhibit RCS-2, Schedule C-12, my adjustment reduces projected 2023 test year cost of service by $38,835.

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[7] Subsection (2) of the 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."

VI. OTHER CONCERNS

Q. DO YOU HAVE ANY CONCERNS ABOUT WHETHER PROJECTED AND FORECAST RATEBASE AND NET OPERATING INCOME ARE REPRESENTATIVE OF THE OPERATIONS OF THE COMPANY DURING THE TIME WHEN PROPOSED RATES ARE EXPECTED TO BE IN EFFECT?

A. Yes. There are a number of concerns that I have along this line after considering the filing and discovery and other information I have reviewed.

Q. PLEASE ELABORATE.

A. The Company was asked in OPC Interrogatory Nos. 143-148 about whether there are current and/or planned internal discussions for the Company to merge or be acquired. The Company objected to answering those requests, but stated in response to OPC Interrogatory No. 143 that:

> Notwithstanding and without waiving this objection, the Company states that, Chesapeake, frequently assesses "potential" transactions that would benefit all stakeholders. The Company is not aware of any such discussions that would impact this proceeding.

Were there to be no such discussions ongoing, a simple "no" would have been sufficient and the OPC and Commission could rely on it. The qualifier "that would impact this proceeding" does not put the matter to rest. In fact, it suggests that FPUC believes that it gets to decide whether any possible discussions impact the determination of a projected test year revenue requirement. The Commission is entitled to be the judge of that and the OPC is entitled to inquire about it to determine if the test year is representative of future operations.

I understand the OPC intends to pursue a motion to compel a substantive response to this. In the likely event that this discovery dispute is not resolved before the deadline for filing testimony, I reserved the right to file supplemental testimony if material information bearing on a potential acquisition of the Company is revealed.

I have also observed that the Company has increased its employee complement to a projected 2023 test year amount of 240.02 from a 2021 year-end amount of 221.83.[8] This type of cost is especially susceptible to modification in merger synergies. I have a serious concern about whether the payroll related costs are reflective of going forward operations if there is a sale or merger of the Company under discussion or likely to occur in the time in which rates are to be in effect.

Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY?

A. Yes, it does.

[8] See the response to OPC Interrogatory No. 30.

(Proceedings concluded.)

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 7th day of November, 2022.

Debbie R Krick

DEBRA R. KRICK
NOTARY PUBLIC
COMMISSION #HH31926
EXPIRES AUGUST 13, 2024