

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)
MICHIGAN GAS UTILITIES CORPORATION)
for authority to increase retail gas rates.)
_____)

Case No. U-15990

DIRECT TESTIMONY OF
CHRISTINE M. PHILLIPS, CPA
FOR
MICHIGAN GAS UTILITIES CORPORATION

July 1, 2009

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**QUALIFICATIONS
OF
CHRISTINE M. PHILLIPS, CPA
PART I**

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

2 A. My name is Christine M. Phillips. My business address is Integrys Business Support
3 (“IBS”), 130 East Randolph Drive, Chicago, Illinois 60601. I am Manager - Benefits
4 Accounting in the Benefits Accounting Department of Integrys Energy Group, Inc.
5 (“Integrys”). Both IBS and Michigan Gas Utilities Corporation (“MGUC”) are wholly-
6 owned subsidiaries of Integrys. Integrys resulted from the February 21, 2007 merger
7 between WPS Resources Corporation and Peoples Energy Corporation.

8

9 **Q. For whom are you providing testimony?**

10 A. I am providing testimony on behalf of MGUC.

11

12 **Q. Please describe briefly your educational, professional, and utility background.**

13 A. I have a Bachelor of Science Degree from Illinois Wesleyan University with a major
14 in Accounting. I am registered in the State of Illinois as a Certified Public Accountant
15 (“CPA”) and have been employed by IBS or its predecessors since May of 1990. In
16 my current position in the Benefits Accounting Department, my primary duties
17 include the accounting for the costs of the employee benefit plans, coordinating the
18 forecasting done by the actuaries, and ensuring accounting and legal compliance of

1 the employee benefit plans and trusts for Integrys and its subsidiaries, including
2 MGUC.

3

4 **Q. Have you previously testified before any regulatory agency?**

5 A. Yes, I have. I have testified before the Public Service Commission of Wisconsin
6 (“PSCW”) in rate case docket 6690-UR-119, and I have submitted testimony before
7 the Michigan Public Service Commission on behalf of Upper Peninsula Power
8 Company in Case U-15988.

**CHRISTINE M. PHILLIPS, CPA
DIRECT TESTIMONY
PART II**

1 **Q. What is the purpose of your pre-filed direct testimony?**

2 A. The purpose of my pre-filed direct testimony is to explain the methodologies used to
3 determine MGUC's forecast of 2010 employee benefit costs.

4

5 **Q. Are you sponsoring any exhibits in this proceeding?**

6 A. Yes, I am. I am sponsoring Exhibit A-3 (CMP-1), Schedule C23.

7

8 **Q. Was this exhibit prepared by you or under your direction and supervision?**

9 A. Yes, it was.

10

11 **Q. Please describe Exhibit A-3 (CMP-1), Schedule C23.**

12 A. Exhibit A-3 (CMP-1), Schedule C23 is a summary, by sub-account, of MGUC's
13 employee benefit costs for the 2008 historic test year, and the 2010 projected test
14 year.

15

16 **Q. What is the current forecast of employee benefit costs for MGUC for 2010?**

17 A. The current forecast of employee benefit costs for MGUC, on a corporate basis, for
18 the 2010 projected year is \$5,543,398. This compares to \$3,843,057 for the 2008
19 historic year, on a corporate basis. This is an increase of \$1,700,341 over a two-
20 year period, or 44.2%. This 44.2% increase over two years corresponds to 20.1%
21 per year.

22

23 **Forecasting Methodologies**

24 **Q. How was the forecast of employee benefit costs for MGUC for 2010**
25 **developed?**

1 A. As shown on Exhibit A-3 (CMP-1), Schedule C23, MGUC divided the forecast of
2 employee benefit costs into four categories. These categories were:

- 3 1. Forecasted 2010 costs that are not requested for rate recovery in 2010,
- 4
- 5 2. Forecasted 2010 costs that were estimated by MGUC,
- 6
- 7 3. Forecasted 2010 costs that were determined by inflating 2008 actual
- 8 costs, and
- 9
- 10 4. Forecasted 2010 costs that were determined through actuarial analysis.

11

12 **Employee Benefit Costs that are Not Requested for Recovery in 2010**
13 **Q. Please describe the forecasted 2010 employee benefit costs that are not**
14 **requested for recovery in 2010.**

15 A. There is one.

16

17 As shown on Exhibit A-3 (CMP-1), Schedule C23, line 1, MGUC is not requesting
18 recovery in 2010 of any costs recorded in Account 926015, as these costs are
19 related to the Integrys merger, and are not expected to re-occur in 2010. MGUC
20 witness Ms. Katherine A. De Cramer has included a Known and Measurable
21 decrease for this item in Exhibit A-3 (KAD-1), Schedule C13.

22

23 **Employee Benefit Costs that were Estimated by MGUC**
24 **Q. Please describe the process used to determine the forecasted 2010 employee**
25 **benefit costs that were determined by estimates by MGUC.**

26 A. The 2010 cost of the MGUC allocation of IBS employee benefits was estimated by
27 MGUC, and the impact of this item is an increase of \$615,920 from 2008 to 2010.

28

29 As shown on Exhibit A-3 (CMP-1), Schedule C23, line 3, MGUC estimates the 2010
30 costs to be \$1,527,055 based on an update of IBS' benefit costs. The 2008 cost was
31 \$911,135. The primary drivers behind the increases are costs determined by
32 actuarial analysis and medical costs for active employees. The cost projections for

1 IBS reflect the same actuarial analyses used for MGUC's costs as described below.
2 Projected medical costs for active employees in 2010 assumed 8% inflation while
3 dental costs assumed 5% inflation. Actual 2008 costs included a one-time reduction
4 related to a change in accounting for medical and dental costs.

5

6 **Employee Benefit Costs that were Determined by Inflating 2008 Actual Costs**
7 **Q. Please describe the process used to determine the forecasted 2010 employee**

8 **benefit costs that were determined by inflation.**

9 A. As shown on Exhibit A-3 (CMP-1), Schedule C23, for certain sub-accounts listed on
10 lines 6 through 23, MGUC inflated 2008 actual costs by the inflation factors
11 developed by MGUC witness Ms. Katherine A. De Cramer in her Exhibit A-7 (KAD-
12 1). The overall increase in costs forecasted by inflating 2008 costs to 2010 was
13 \$72,246, or 4.6%. This 4.6% increase over two years corresponds to 2.3% per year.

14

15 **Q. Has MGUC been able to control the increase in active employee health care**
16 **expenses?**

17 A. Yes, it has. As a direct result of the formation of Integrys, MGUC has been able to
18 gain discounts from its larger buying power, which have provided significant savings
19 in our medical plan. This buying power leverage can also be seen in our prescription
20 drug costs, with discounts we are now receiving after joining an employer-based
21 coalition plan in 2008.

22

23 We have also reduced costs through benefit plan design changes for all employees
24 and retirees. In 2008, we implemented new medical plans for all non-union
25 employees and pre-Age 65 retirees, including two high deductible plans. These new
26 plans include robust disease management and wellness programs to assist
27 participants with their care for chronic conditions, and emphasize wellness and
28 lifestyle changes.

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Employee Benefit Costs that were Determined by Actuarial Analysis

Q. Please describe the process used to determine the forecasted 2010 employee benefit costs that were determined by actuarial analysis.

A. As shown on Exhibit A-3 (CMP-1), Schedule C23, for four sub-accounts, MGUC relied on an actuarial analysis to determine forecasted 2010 employee benefit costs. The specific methods and assumptions employed are described below. The overall increase in costs from 2008 to 2010 forecasted by actuarial analysis is \$1,056,777, or 79.7%. This 79.7% increase over two years corresponds to 34.1% per year.

The 2010 employee benefit costs that were determined by actuarial analysis are related to:

1. Employee Pension Expense,
2. Survivor Income Benefit Plan,
3. Post Retirement Medical, and
4. Pension Restoration and Supplemental Pension Plan Expense.

Employee Pension Expense

Q. Please describe the development of the pension expense shown on line 26 of Exhibit A-3 (CMP-1), Schedule C23.

A. Pension expense is determined using actuarial analysis, which is performed in accordance with SFAS No. 87. MGUC follows Generally Accepted Accounting Principles ("GAAP") for its financial statements. Under the provisions of GAAP, SFAS No. 87 describes the methodologies and assumptions used to calculate and account for pension expense. SFAS No. 87 requires an annual determination of the pension expense for the year. This expense is determined by the actuary each year based upon its review of:

1. Employee census data,

- 1 2. Current plan provisions,
- 2 3. Plan asset performance, and
- 3 4. Certain other actuarial assumptions.

4

5 For the SFAS No. 87 pension expense, MGUC's actuary, (Towers Perrin ("Towers")
6 since January 2008, and Mercer Human Resource Consulting ("Mercer") through
7 2007), performs the calculations required by this accounting standard annually to
8 determine MGUC's pension expense. MGUC's external auditors, Deloitte & Touche
9 ("D&T"), review the actuarial assumptions used to ensure consistency with GAAP.

10

11 There are four components of the SFAS No. 87 pension expense. They are:

- 12 1. Service cost,
- 13 2. Interest cost,
- 14 3. Expected earnings on plan assets, and
- 15 4. Amortization of gains and losses, prior service costs, and any transitional
16 amounts.

17

18 Service cost represents one-year's pro-rata share of the expected benefits earned
19 during the year by current active employees.

20

21 Interest cost represents interest on the plan's benefit obligation (its liabilities) due to
22 the passage of time.

23

24 There is also an assumption made of the expected return on assets for the year,
25 which gets measured against the actual returns for the period. This rate of return
26 assumption is intended to be a long-term assumption of return on plan assets.

27

28 The final component represents amortization of various plan experiences that were

29

1 not anticipated by actuarial assumptions.

2

3 In order to calculate the plan's total benefit obligation and annual SFAS No. 87
4 expense, the actuary uses a number of assumptions including:

- 5 1. Mortality tables,
- 6 2. Retirement rates from MGUC,
- 7 3. Anticipated salary increases, and
- 8 4. A discount rate.

9

10 Integrys management, as well as MGUC's external auditor, D&T, reviews these
11 assumptions.

12

13 The actuary then calculates the annual SFAS No. 87 pension expense for MGUC.
14 This amount was \$(161,227) in 2008, and is projected to be \$573,000 for 2010. This
15 is an increase of \$734,227. This increase results primarily from lower than
16 forecasted asset returns during 2008.

17

18 Also included in this expense for both 2008 and 2010 is \$821,606 of the amortization
19 shown on page 1 of Exhibit A-3 (KAD-1), Schedule C20, as authorized by the
20 Commission's January 9, 2007 Order in Case No. U-15138.

21

22 **Q. What action has MGUC taken to help control pension costs?**

23 A. As a result of the formation of Integrys, the company made some changes to the
24 retirement benefits provided to nonunion employees. The most significant change
25 was a shift from the traditional defined benefit pension plan to a defined contribution
26 model integrated with the 401K plan. Effective January 1, 2008, the pension plan
27 was closed to administrative (non-union) new hires. Those employees participating

1 in the pension plan as of January 1, 2008 will continue to accrue pension benefits
2 through December 31, 2012; pay used in the calculation of pension benefits will be
3 frozen after December 31, 2017. Those employees not participating in the pension
4 plan will have an annual contribution made to their 401K account.

5
6 **Survivor Income Benefit Plan**

7 **Q. Please describe the development of the survivor income benefit plan expense
8 shown on line 27 of Exhibit A-3 (CMP-1), Schedule C23.**

9 A. The 2010 forecasted expense for post-retirement life insurance is calculated in
10 accordance with the requirements of SFAS No. 106, identical to the Post Retirement
11 Medical Expense described below. This amount was \$(34,841) in 2008, and is
12 projected to be \$(14,000) in 2010.

13
14 **Post Retirement Medical**

15 **Q. Please describe the development of the post retirement medical expense
16 shown on line 28 of Exhibit A-3 (CMP-1), Schedule C23.**

17 A. The expense for retirees is determined using actuarial analysis, which is performed
18 in accordance with SFAS No. 106. As stated above, MGUC follows GAAP for its
19 financial statements. Under the provisions of GAAP, SFAS No. 106 describes the
20 methodologies and assumptions used to calculate and account for retiree health
21 care expense.

22
23 The actuary performs the calculations required by this accounting standard annually
24 to determine MGUC's SFAS No. 106 expense. D&T reviews the actuarial
25 assumptions used to ensure consistency with GAAP.

26
27 SFAS No. 106 requires an annual determination of the retiree health care expense
28 for the year, also referred to as Other Post Employment Benefits ("OPEB") expense

1 or Post Employment Benefits other than Pension (“PBOP”). This expense is
2 determined by the actuary each year based upon their review of:

- 3 1. Employee census data,
- 4 2. Current plan provisions,
- 5 3. Plan asset performance, and
- 6 4. Certain other actuarial assumptions.

7

8 There are four components of SFAS No. 106 expense:

- 9 1. Service cost,
- 10 2. Interest cost,
- 11 3. Expected earnings on plan assets, and
- 12 4. Amortization of gains and losses, prior service costs, and any transitional
- 13 amounts.
- 14
- 15
- 16
- 17

18 These are the same four components that are used in the calculation of pension
19 expense, though different assumptions are used for health care.

20

21 In order to calculate the plan’s total benefit obligation and annual SFAS No. 106
22 expense, the actuary uses a number of assumptions including:

- 23 1. Health care inflation trend rates,
- 24 2. Mortality tables,
- 25 3. Retirement rates from MGUC,
- 26 4. Actual retiree health care claims experience specific to MGUC, and
- 27 5. A discount rate.

28

29 Integrys management, as well as MGUC’s external auditor, D&T, reviews these
30 assumptions.

31

1 The actuary then calculates the annual SFAS No. 106 expense component for each
2 year, which was \$(134,853) for the 2008 historic test year, and is projected to be
3 \$171,000 for the 2010 projected test year. This increase results primarily from lower
4 than forecasted asset returns during 2008. The key actuarial assumptions used in
5 the expense projection by Towers included:

- 6 a. 6.50% discount rate,
- 7
- 8 b. 8.5% return on assets,
- 9
- 10 c. 10% medical cost trend rate for those under age 65, and 10.5% for those
- 11 over age 65, and
- 12
- 13 d. The RP2000 Combined Mortality Table Projected to 2010.
- 14

15 The calculation also reflects MGUC's acceptance of the government subsidy
16 available under the Medicare prescription drug legislation.

17

18 Also included in this expense for both 2008 and 2010 is \$729,659 of the amortization
19 shown on page 1 of Exhibit A-3 (KAD-1), Schedule C20, as authorized by the
20 Commission's January 9, 2007 Order in Case No. U-15138.

21

22 Furthermore, included in this expense for both 2008 and 2010 is \$31,068 of the
23 amortization shown on page 1 of Exhibit A-3 (KAD-1), Schedule C20, as authorized
24 by the Commission's December 8, 1992 Order in Case No. U-10040.

25

26 **Q. Have the underlying health care costs for retirees increased?**

27 A. Yes, they have. Consistent with the national trend, underlying health care costs for
28 retirees have increased and are projected to continue to increase for MGUC each
29 year. This trend of higher health care cost increases is expected to continue for a
30 couple of reasons.

31

1 First, health care claim costs continue to rise sharply, still outpacing general inflation.

2 There are a number of reasons for this rapid rise in costs:

- 3 1. The covered population in the health plans is aging and living longer, and
4 therefore use more health services,
5
- 6 2. New, expensive medical technology continues to become available,
7 driving up costs,
8
- 9 3. The government continues to shift costs from its plans,
10
- 11 4. Provider malpractice liability costs continue to soar, and are reflected in
12 service prices, and
13
- 14 5. New, expensive prescription drugs continue to enter the market,
15 prescription drug prices continue to rise and prescription usage is
16 increasing.
17

18 Second, SFAS No. 106 requires the use of a discounting process to set a value on
19 all future benefit payments. The discount rate is the interest rate selected as of the
20 expense measurement date used to determine the present value of the future
21 outflow of retiree health care payments. The discount rate selected needs to reflect
22 current economic conditions at the time the expense is determined. Lower discount
23 rates create higher expenses under the SFAS No. 106 accounting for expense, as
24 was seen under the SFAS No. 87 accounting for pension expense explained above.
25 A discount rate of 6.50% was used to forecast the 2010 expense.

26

27 **Pension Restoration and Supplemental Pension Plan Expense**

28 **Q. Please describe the development of the executive deferred compensation**

29 **pension equalization expense shown on line 29 of Exhibit A-3 (CMP-1),**

30 **Schedule C23.**

31 A. The Pension Restoration and Supplemental Pension Plan expense is calculated in
32 accordance with SFAS No. 87 accounting rules, identical in nature to the Employee
33 Pension Expense described above.

34

35 The Pension Restoration and Supplemental Pension Plan expense adjustment is a

1 decrease of \$4,145.

2

3 Included in this expense for both 2008 and 2010 is \$12,346 of the amortization
4 shown on page 1 of Exhibit A-3 (KAD-1), Schedule C20, as authorized by the
5 Commission's January 9, 2007 Order in Case No. U-15138.

6

7 Also included here is \$9,716 of Deferred Income Plan expense that was determined
8 by using the Moody's Corporate Bond Yield Average A of 6.85% to inflated 2008
9 historic test year values to the 2010 projected test year.

10

11 **Q. Does this complete your pre-filed direct testimony?**

12 A. Yes, it does.