Company:	Southern California Gas Company (U 904 G)/San Diego Gas & Electric Company (U 902 M)
Proceeding:	2019 General Rate Case
Application:	A.17-10-007/008 (cons.)
Exhibit:	SCG-231/SDG&E-229

SOCALGAS/SDG&E

REBUTTAL TESTIMONY VOLUME

***

REBUTTAL TESTIMONY OF DEBBIE S. ROBINSON

(CHAPTER 1)

***

REBUTTAL TESTIMONY OF YANNICK GAGNE

(CHAPTER 2)

***

(PENSION AND POSTRETIREMENT BENEFITS OTHER THAN PENSION)

June 18, 2018

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

CHAPTER 1

REBUTTAL TESTIMONY OF DEBBIE S. ROBINSON

(PENSION AND POSTRETIREMENT BENEFITS OTHER THAN PENSION)

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CHAPTER 1
SOCALGAS/SDG&E REBUTTAL TESTIMONY OF DEBBIE S. ROBINSON
(PENSION AND POSTRETIREMENT BENEFITS OTHER THAN PENSION)

I. SUMMARY OF DIFFERENCES

Office of Ratepayer Advocates (ORA), The Utility Reform Network (TURN) and Indicated Shippers

TABLE DSR-1 – SoCalGas

Component	2019 GRC				
	SoCalGas Request ($M)	ORA Recommendation ($M)	Difference	TURN Recommendation	Difference - TURN vs. SCG
Pension	$ 202.8	$ 202.8	$ -	$ 90.7	$ (112.1)
PBOPs	$ -	$ -	$ -	$ -	$ -
Total Pension & PBOPs	**$ 202.8**	**$ 202.8**	**$ -**	**$ 90.7**	**$ (112.1)**

TABLE DSR-2 – SDG&E

Component	2019 GRC				
	SDG&E Request ($M)	ORA Recommendation ($M)	Difference - ORA vs. SDG&E	TURN Recommendation	Difference - TURN vs. SDG&E
Pension	$ 64.0	$ 64.0	$ -	$ 29.1	$ (35.0)
PBOPS	$ 1.4	$ 1.4	$ -	$ 1.4	$ -
Total Pension & PBOPS	**$ 65.4**	**$ 65.4**	**$ -**	**$ 30.5**	**$ (35.0)**

Indicated Shippers (Shippers)

TABLE DSR-3 – SoCalGas

Component	2019 GRC		
	SoCalGas Request ($M)	Shippers Recommendation ($M)	Difference - Shippers vs. SCG
Pension	$ 202.8	$ 124.7	$ (78.1)
PBOPs	$ -	$ -	$ -
Total Pension & PBOPs	**$ 202.8**	**$ 124.7**	**$ (78.1)**

II. INTRODUCTION

This rebuttal testimony regarding Southern California Gas Company's (SoCalGas) and San Diego Gas & Electric Company's (SDG&E) (collectively, the Companies) request for Pension and Postretirement Benefits Other Than Pension (PBOPs) addresses the following testimony from other parties:

- The ORA as submitted by Ms. Stacey Hunter (Exhibit ORA-22), dated April 13, 2018.
- TURN, as submitted by Ms. Jaime McGovern (Exhibit TURN-06), dated May 14, 2018.
- The Shippers, as submitted by Mr. Michael P. Gorman (Exhibit IS-1), dated May 14, 2018.

In addition to my rebuttal testimony, this exhibit includes:

- Rebuttal testimony sponsored by Yannick Gagne, Senior Director and Head of Retirement – Southwest with the Companies' actuary, Willis Towers Watson (Chapter 2).
- A primer on U.S. GAAP[1] pension accounting (Appendix I).
- A summary of factual errors or misrepresentations in TURN's testimony (Appendix II).

Please note that the fact that I may not have responded to every issue raised by others in this rebuttal testimony does not mean or imply that the Companies agree with the proposal or contention made by these or other parties. The forecasts contained in SoCalGas and SDG&E's direct testimony, performed at the project level, are based on sound estimates of its revenue requirements at the time of testimony preparation.

Pension and PBOPs are key components of a competitive total compensation program that enables the Companies to attract and retain a high-performing workforce. The Commission has a longstanding practice of providing funding for pension and PBOP benefits that are offered as part of a reasonable total compensation program. SoCalGas' and SDG&E's total compensation programs are in line with the market and reasonable.

[1] Generally Accepted Accounting Principles in the United States of America (GAAP).

The Total Compensation Study, which was prepared by Willis Towers Watson, found that SoCalGas' actual total compensation (defined as base salaries, short-term incentives, long-term incentives and benefits) is within 0.7% of market and target total compensation is within 1.2% of market; and SDG&E's total compensation is within 0.4% of market based on actual total compensation and target total compensation is within 1.5% of market.[2] In Decision (D.) 95-12-055, the Commission affirmatively stated that compensation levels that fall between plus or minus five percent of the relevant market are considered to be "at market" and reasonable.[3] Thus, both SoCalGas' and SDG&E's compensation is reasonable based on the standards set by the Commission.

SoCalGas and SDG&E are proposing a change in their pension funding methodology in order to mitigate a funding shortfall and avoid generational equity issues where future ratepayers would be asked to fund costs that benefited earlier generations. SoCalGas' and SDG&E's proposed pension funding methodology is consistent with the Commission's historical practice of providing for ratepayer funding of pension plan costs based on California utilities' cash contributions to their pension plans. Historically, for SoCalGas and SDG&E, funding has been based on the minimum required contribution under the Employee Retirement Income Security Act of 1974 (ERISA), and a two-way balancing account is used to adjust for any differences between forecasted and actual contributions.

The differences between the amounts requested by SoCalGas and SDG&E and the amounts proposed by ORA and TURN are summarized above in Table DSR-1 (for SoCalGas) and Table DSR-2 (for SDG&E). The differences between the amounts requested by SoCalGas and the amounts proposed by Shippers are summarized above in Table DSR-3. ORA does not take issue with SoCalGas' and SDG&E's pension and PBOP funding forecast or the proposed change in pension funding methodology. TURN and Shippers take issue with the pension funding forecast and propose alternative pension funding methodologies.

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[2] October 6, 2017, Prepared Direct Testimony of Debbie S. Robinson (Compensation and Benefits), Exhibit SCG-30/SDG&E-28 (Robinson) at 5-8 and Appendix A.

[3] D.95-12-055, 1995 Cal. PUC LEXIS 965 at *33-34.

A. ORA

ORA issued its report on Pension and PBOPs on April 13, 2018.[4] The following is a summary of ORA's position(s):

- ORA does not take issue with either SoCalGas' or SDG&E's pension benefits expense or methodology change requests.
- ORA does not take issue with either SoCalGas' or SDG&E's PBOP requests.
- ORA recommends continuance of two-way balancing accounts for pension and PBOPs.

B. TURN

TURN submitted testimony on May 14, 2018.[5] The following is a summary of TURN's position(s):

- Rather than determine future contributions based on funding the current pension shortfall over seven years plus the service cost component of "GAAP Pension Expense," TURN proposes that future contributions be based on total "GAAP Pension Expense."
- TURN contends that the company made discretionary unauthorized retirement incentive payments increasing pension liabilities, and that SoCalGas' and SDG&E's shareholders should contribute a total of $30 million for SoCalGas and $16 million for SDG&E in addition to the amounts of authorized ratepayer contributions.
- TURN contends that the current unfunded pension liability is a result of SoCalGas underfunding its pension plan by masking actual pension expenses for years. As a result, TURN recommends that SoCalGas be responsible for 20% of any additional contribution above the GAAP

[4] April 13, 2018, Prepared Direct Testimony of Stacey Hunter, Report on the Results of Operations for San Diego Gas & Electric Company, Southern California Gas Company Test Year 2019 General Rate Case, Compensation & Benefits; Pension & Postretirement Benefits Other Than Pension, Ex. ORA-22.

[5] May 14, 2018, Prepared Direct Testimony of Jaime McGovern Addressing the Proposals of San Diego Gas & Electric Company and Southern California Gas Company in Their 2019 General Rate Case Related to Pension and Postretirement Benefits Other Than Pension, on behalf of The Utility Reform Network, Ex. TURN-6.

Pension Expense that may be required in order to meet the Minimum Required Contribution or maintain an 85% Adjusted Funding Attainment Percentage.

- TURN recommends that if the Commission adopts the Companies' proposal to use service cost plus the amortization of Projected Benefit Obligation (PBO) shortfall (plan PBO, as calculated under GAAP, in excess of Plan Assets), then the Companies should amortize the PBO Shortfall over 20 years and not the proposed seven years, and cover 10% of the actual shortfall amount embedded in the contribution calculation.

C. Indicated Shippers

The Indicated Shippers (Shippers) submitted testimony on May 14, 2018.[6] The following is a summary of Shippers' position(s):

- Shippers contends that the current pension funding policy is appropriate and should not be modified.
- Shippers recommends that if SoCalGas' proposed funding policy is adopted that the amortization period of PBO shortfall should be 21 years rather that the seven years in the proposed policy.
- Shippers does not take issue with SoCalGas' inclusion of the service cost component of "GAAP Pension Expense" in the calculation of the annual funding amount proposed in the new pension funding policy.
- Shippers does not take issue with SoCalGas' continuance of two-way balancing accounts for pension and PBOPs.

III. REBUTTAL TO TURN'S AND SHIPPERS' PENSION FUNDING PROPOSALS

SoCalGas' and SDG&E's current pension plan funding policy (used to determine the expense allowed by the settlement of the Companies' test year (TY) 2016 General Rate Case and the TY 2012 General Rate Case) is based on the minimum required contributions in accordance

[6] May 14, 2018, Prepared Direct Testimony of Michael P. Gorman Addressing the Application of Southern California Gas Company (U904G) for Authority, Among Other Things, to Update its Gas Revenue Requirement and Base Rates Effective on January 1, 2019 And Related Matters, Ex. IS-1.

with ERISA and as allowed by the Internal Revenue Code (IRC), but no less than the amount sufficient to maintain an 85% Adjusted Funding Target Attainment Percentage.

The Pension Protection Act of 2006 (PPA) sets minimum required contributions at a level designed to achieve full funding within seven years. As noted in Debbie Robinson's direct testimony, subsequent federal legislation[7] resulted in lower than projected minimum required contributions, the approved regulatory mechanism for pension funding and cost recovery. TURN and Shippers fail to acknowledge or appreciate the impacts of the change in law on SoCalGas' and SDG&E's funding mechanism. If not for the changes in the calculation of ERISA minimum contribution amounts, the current request would have been much lower and the PPA funding requirements would have minimized or eliminated the current shortfall.

For SoCalGas and SDG&E, the growth in the pension liability has outpaced contributions, creating a significant funding shortfall. This funding shortfall increases long-term costs to ratepayers due to higher Pension Benefit Guaranty Corporation premiums and higher accrued interest costs. In addition, deferring funding creates generational equity issues where future ratepayers will be asked to fund costs that benefited earlier generations.

SoCalGas' and SDG&E's proposed methodology stops the continued underfunding of the Projected Benefit Obligation[8] and targets its full funding within seven years. Recovery is based on the greater of:

- The annual service cost[9] plus a seven-year amortization of the Projected Benefit Obligation shortfall;
- The annual ERISA (as modified by PPA) minimum required contribution; or

[7] October 6, 2017, Prepared Direct Testimony of Debbie S. Robinson (Pension and Postretirement Benefits Other Than Pension), Ex. SCG-31/SDG&E-29 at 7-10.

[8] As determined pursuant to Subtopic 715-30 of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC 715-30), the authoritative source of GAAP). The Projected Benefit Obligation is an estimate of the present value of expected future benefit payments and is a widely accepted measure of a plan's liabilities. See Appendix I, p. 30 for additional information.

[9] Service cost refers to the present value of the projected **retirement** benefits earned by plan participants in the current period. Generally, a company's **pension service cost** is the amount it must set aside in the current period to match the **retirement** benefits accrued by plan participants during the year.

- The contribution required to maintain an 85% Adjusted Funding Attainment Percentage.

Annual contributions will be limited so that the contribution does not result in pension assets exceeding 110% of the Projected Benefit Obligation.

A. TURN's Proposal to Adopt a Pension Funding Methodology Based on GAAP Pension Expense.

TURN's primary proposal is to adopt a pension plan funding methodology based on "GAAP Pension Expense."[10] Rather than determine future contributions based on funding the current pension shortfall over seven years, TURN proposes that future contributions be based on GAAP Pension Expense, which TURN defines as current service cost, interest cost, expected return on assets, amortization of prior service cost, and amortization of unamortized gains or losses. However, according to ASC 715-30, TURN should have also included special accounting events such as settlements, curtailments, and special termination benefits, but they did not.[11] In addition to this discrepancy, there are several reasons why funding pension expense based on GAAP Pension Expense is not appropriate:

- Use of GAAP Pension Expense would partially ignore the current deficit, leaving $303.4 million in existing pension obligation unfunded;
- Even if GAAP Pension Expense is negative, federal pension regulations prohibit the removal of assets from pension trusts until benefit obligations have been satisfied;
- The amortization period for GAAP is inconsistent with ERISA minimum funding requirements; and
- GAAP Pension Expense can be quite volatile, as it must include settlement and other special accounting charges.

Mr. Gagne addresses TURN's proposals and SoCalGas' and SDG&E's concerns in detail in Chapter 2 of this exhibit.

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[10] As defined by Subtopic 715-30 of the FASB ASC 715-30, the authoritative source of Generally Accepted Accounting Principle.

[11] The components of Net Periodic Benefit Cost (which TURN refers to as "GAAP Pension Expense"), as specified under ASC 715, are described in Appendix I, at 31-35.

B. TURN's Contention that SoCalGas and SDG&E Made Discretionary Unauthorized Retirement Incentive Payments Increasing Pension Liabilities.

TURN asserts that a portion of the pension plan funding shortfall was caused by "unauthorized practices" by SoCalGas and SDG&E in offering voluntary retirement incentives. TURN argues shareholders should contribute a total of $30 million for SoCalGas and $16 million for SDG&E in addition to the amounts of authorized ratepayer contributions. According to TURN:

> Some of the PBO Shortfall is the result of unauthorized practices by the Companies, especially the provision of benefits through the Voluntary Retirement Enhancement Program (VREP), which results in higher cost to ratepayers.[12]

As explained in Mr. Gagne's testimony in Chapter 2 of this exhibit, accounting standards require accelerated recognition of deferred gains or losses when total lump sum benefit distributions for a plan year exceed a pre-determined threshold. In this case, the number of employees who elected VREP increased total lump sum pension distributions resulting in the settlement charge. Because the lump sum payments relieved the plans of future benefit obligation and associated risk relating to pension plan benefits, a settlement was required, as Mr. Gagne explains. In the normal course, the accumulated deferred gains or losses would have been recognized in future periods. Consequently, the VREP simply affected the timing of pension distributions and the associated settlement charge. It is also important to note that the VREP, a postretirement health benefit, did not affect the pension benefits provided to VREP participants.

SoCalGas and SDG&E also take issue with TURN's implication that retirement incentives require advance authorization by the Commission. Such incentives are an important workforce planning tool, allowing SoCalGas and SDG&E to manage the level of skills and experience required to continually improve efficiency and effectiveness in a dynamic business environment. TURN acknowledges that they are not aware of any Commission authorizing, or declining to authorize, a similar voluntary retirement incentive program:

SDG&E Asked:

> Is TURN aware of any state legislation or public utilities commission decisions authorizing or declining to authorize a program similar to the Companies' recent VREP? If yes, please identify any and all citations to all statutes and/or public utilities commission decisions.

TURN Responded:

[12] Ex. TURN-06 (McGovern) at 7.

TURN is not aware of any other Commission authorizing or declining to authorize a similar voluntary retirement incentive program.[13]

C. TURN's Argument that SoCalGas Should Pay for 20% of Required Contributions in Excess of the GAAP Pension Expense.

TURN contends that the current unfunded pension liability is a result of SoCalGas underfunding its pension plan by masking actual pension expenses for years. As a result, TURN recommends that SoCalGas be responsible for 20% of any additional contribution above the GAAP Pension Expense that may be required in order to meet the Minimum Required Contribution or maintain an 85% Adjusted Funding Attainment Percentage.

TURN vaguely implies that SCG acted improperly in funding its plan, while offering no support for its claim, stating:

> SoCalGas has underfunded its plan, and contributed to the PBO, through years of masking actual pension expense on their balance sheet and making unknown and non-transparent benefits decisions.[14]

This argument ignores the fact that both SoCalGas and SDG&E funded their plans using the funding methodology authorized by the Commission and based on certified actuarial calculations. TURN also fails to provide support for its contention that the underfunding of SoCalGas' PBO is due to years of unknown and non-transparent decisions about benefits. These issues are discussed in detail in Mr. Gagne's testimony in Chapter 2 of this exhibit.

D. TURN's Secondary Recommendation Regarding the Amortization Period for Funding the Projected Benefit Obligation Shortfall.

If the Commission adopts SoCalGas' and SDG&E's proposed funding methodology based on the service cost and amortization of the PBO shortfall, TURN recommends against amortizing the PBO shortfall over seven years. Instead, TURN proposes amortizing any shortfall over 20 years and requiring shareholders to pay 10% of the PBO shortfall amount contributed to the plan each year.

SoCalGas and SDG&E strongly disagree with TURN's proposed approach. TURN's approach is unreasonable because it:

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[13] TURN Response to SDG&E/SoCalGas Data Request 03, Question 6.

[14] Ex. TURN-06 (McGovern) at 5.

- Ignores the fact that SoCalGas and SDG&E funded their plans in accordance with the funding methodology authorized by the Commission;
- Exacerbates generational equity issues by funding the PBO shortfall over 20 years. Ratepayers in 2039 will be paying for the existing shortfall;
- Arbitrarily assigns 10% of the funding for contributions related to the PBO shortfall to shareholders based on a vague assertion that SoCalGas and SDG&E underfunded their plans and contributed to "untraceable increases to the PBO."

Mr. Gagne's testimony discusses the shortcomings of TURN's proposal in more detail in Chapter 2 of this exhibit.

E. Shippers' Recommendation Regarding Amortization Period for Funding the Projected Benefit Obligation Shortfall.

Shippers recommends that if SoCalGas' new funding policy is adopted, the Pension Plans' PBO shortfall should be amortized over 21 years and not the seven years in the proposed funding policy. Shippers contends that the suggested 21-year period is based on the number of years between the average age of a SoCalGas pension plan participant and the plan's normal retirement age of 65.

SoCalGas strongly disagrees with Shippers' proposed approach. Shippers' approach is unreasonable because it:

- Ignores the fact that SoCalGas funded its pension plan in accordance with the funding methodology authorized by the Commission;
- Fails to take into account that under the plan, a participant's full benefit can be paid as a lump sum upon termination of employment, which can be significantly sooner than age 65;
- Fails to recognize that the unfunded liability is for past years of employment (a portion of which is for former employees and retirees), and that the related pension benefits were received by a prior generation of customers;
- Incorrectly calculates the remaining expected average service of eligible employees;
- Exacerbates generational equity issues by funding the PBO shortfall over 21 years. Ratepayers in 2040 will be paying for the existing shortfall; and

- Fails to acknowledge the original statutory mandate under the PPA that required plans to attain full funding status over a seven-year period.

IV. CONCLUSION

To summarize, TURN's and Shippers' proposals to adopt alternative pension plan funding methodologies contain factual errors, unfounded assertions, and misrepresentations, which are discussed in detail in Mr. Gagne's testimony. SoCalGas' and SDG&E's proposed pension funding methodology is reasonable and should be adopted.

This concludes my prepared rebuttal testimony.

CHAPTER 2
SOCALGAS/SDG&E
REBUTTAL TESTIMONY OF YANNICK GAGNE
(PENSION AND POSTRETIREMENT BENEFITS OTHER THAN PENSION)

CHAPTER 2
SOCALGAS/SDG&E REBUTTAL TESTIMONY OF YANNICK GAGNE
(PENSION AND POSTRETIREMENT BENEFITS OTHER THAN PENSION)

I. INTRODUCTION

For decades, the Commission has approved the pension benefits provided by the Companies as an appropriate component of a market-competitive total compensation program. As a result, the cost associated with this benefit is a recoverable cost. In addition, long-standing practice in California has been to allow utilities to recover the amount of cash contributions made to the pension plans, which for the Companies has been the minimum required contribution, using a two-way balancing account to adjust for any differences between forecasted and actual contributions. Neither ORA nor TURN oppose the continuation of the two-way balancing account to true up forecasted and actual pension contributions.

Congress adopted a number of changes to minimum contribution calculation rules under the PPA in recent years, which artificially reduced the pension liability and, therefore, the required contributions. As a result, funding the 'new' minimum required contribution has contributed to the deficits under the plans, and renders it inappropriate as a funding mechanism going forward. TURN agrees with the Companies that a more sustainable and transparent approach to annual pension contributions is beneficial.

The Companies propose a simple solution to this problem, which involves changing the actuarial basis used in calculating pension contributions to the Service Cost (new benefit accruals) and PBO (obligation for benefits attributable to past years of service) as defined under ASC 715-30. This approach more closely aligns with the original intent of PPA of funding the pension obligation based on market interest rates, while promoting a degree of contribution stability. The Companies' proposed solution also includes a mechanism to prevent inappropriate levels of overfunding.

After review of the Companies' proposal, ORA does not take issue with the change in pension funding methodology.

TURN has proposed an alternative basis for recovery, namely Pension Expense under ASC 715 ("GAAP Pension Expense"). This modification would represent a significant structural change that does not "ensure … intergenerational equity for ratepayers," nor does it "ensure … a healthy plan," as TURN claims.[15] Such an approach could be appropriate if adopted at the plans' inception; however, given the past basis for recovery, there is more than $300 million of current pension deficit that would <u>not</u> be recognized in future GAAP Pension Expenses. Furthermore, GAAP Pension Expense can be negative; however, legislation prohibits plan assets from being returned to ratepayers in this situation. Such an arrangement could result in overcollection from ratepayers, and could amplify intergenerational inequity for ratepayers.

TURN also makes claims that the Companies have made unauthorized retirement incentive payments and unknown benefits decisions that have contributed to the increase in pension liabilities. Such claims are based on TURN's misunderstanding of the impact accelerated distributions have on pension deficit, what triggers settlement accounting charges under US GAAP, how such amounts are calculated, and what they represent. The settlement accounting charges stated do not represent the value of any pension benefit enhancement; rather they represent an acceleration of costs (related to deferred losses) that would otherwise be included in future GAAP Pension Expenses.

II. SUMMARY OF ISSUES

A. ORA

ORA issued its report on pension and postretirement benefits other than pensions on April 13, 2018.[16] The following is a summary of ORA's position(s):

- ORA does not take issue with either SoCalGas' or SDG&E's pension benefits expense or methodology change requests.
- ORA recommends the continuation of the two-way balancing account.

B. TURN

TURN submitted testimony on May 14, 2018.[17] The following is a summary of TURN's position(s):

- Rather than determine future contributions based on funding the current pension shortfall over seven years plus the service cost component of

[15] Ex. TURN-6 (McGovern) at 8.

[16] Ex, ORA-22 (Hunter) at 37.

[17] Ex. TURN-6 (McGovern) at 3-5.

"GAAP Pension Expense," TURN proposes that future contributions be based on total "GAAP Pension Expense."

- TURN contends that the company made discretionary unauthorized retirement incentive payments increasing pension liabilities, and that the Companies' shareholders should contribute a total of $30 million for SoCalGas and $16 million for SDG&E in addition to the amounts of authorized ratepayer contributions.
- Further, TURN contends that the current unfunded pension obligation is a result of the SoCalGas underfunding its pension plan by masking actual pension expenses for years. As a result, TURN recommends that SoCalGas be responsible for 20% of any additional contribution above the GAAP Pension Expense that may be required in order to meet the Minimum Required Contribution (MRC) or maintain an 85% Adjusted Funding Attainment Percentage (AFTAP).
- Lastly, TURN recommends that if the Commission adopts the Companies' proposal to use service cost plus seven-year amortization of PBO shortfall, then the Companies should cover 10% of the actual shortfall amount embedded in the contribution calculation.

C. Indicated Shippers

The Shippers submitted testimony on May 14, 2018.[18] The following is a summary of Shippers' positions:

- Shippers contends that the current pension funding policy is appropriate and should not be modified.
- Shippers recommends that if SoCalGas' proposed funding policy is adopted that the amortization period of PBO shortfall should be 21 years rather that the seven years in the proposed policy.

[18] *See* Ex. IS-1.

- Shippers does not take issue with SoCalGas' inclusion of the service cost component of "GAAP Pension Expense" in the calculation of the annual funding amount proposed in the new pension funding policy.
- Shippers does not take issue with SoCalGas' continuance of two-way balancing accounts for pension and PBOPs.

III. EXECUTIVE SUMMARY AND BACKGROUND

Pension benefits represent a commitment to pay participants a defined benefit amount at some point in the future. At the participant's discretion, in most cases the benefit can be either paid as a single sum (also known as a lump sum) or a monthly annuity payable for the life of the participant (and in some cases the life of the participant's beneficiary). Federal law requires that the Companies set aside funds in advance of benefit payments being due, and such contributions are made to a dedicated trust where they are invested.

Many factors will affect the ultimate cost of a pension plan. Participants' service with the Companies, their salaries, when they elect to retire, the form of payment selected as well as how long participants (and possibly their beneficiaries) will live all affect the ultimate cost of this benefit. Because all those factors will not be exactly known for decades into the future, actuarial estimates must be made to determine the expected present value (liability) of those pension benefits.

For decades, the Commission has approved the pension benefits provided by the Companies as a reasonable component of a market-competitive total compensation program. As a result, the cost associated with this benefit is a recoverable cost. In addition, long-standing practice in California has been to allow utilities to recover the amount of cash contributions made to the pension plans – which for the Companies has been tied to the minimum required contribution (as determined under ERISA) – using a two-way balancing account to adjust for any differences between forecasted and actual contributions. This ensures that:

1) All amounts funded by ratepayers for purposes of providing a pension benefit are set aside in a dedicated trust and cannot be used for other purposes;
2) If the plan experiences significant gains resulting in full funding, ratepayers will receive the benefit from reduced (or elimination of) pension contributions;
3) Legal restrictions within the funding mechanism (for example, the inability to pull assets out of the pension trust until all obligations have been satisfied) are

automatically built into the mechanism, and no additional tracking or adjustments are necessary, which keeps the process simple; and

4) Actual pension contributions always equal the amount recovered. This avoids situations where the Companies would provide additional capital to pre-fund a ratepayer obligation, in which case such capital would be added to rate base and be eligible to receive a rate of return from ratepayers.

There is no question that pension assets will ultimately have to be sufficient to pay all promised benefits. Any amount not funded now will have to be funded later, and while there exists an array of reasonable methodologies to allocate costs to periods of service, it boils down to two main components:

1) The value of new pension benefits accrued by employees for the period; and

2) Funding of shortfall for <u>previously</u> provided benefits (when existing assets are insufficient to cover the liability associated with services rendered in the past).

Calculating these two main components requires a few pieces of information:

1) Actuarial basis (assumptions) to calculate the value of new benefits earned during the year;

2) The actuarial basis to calculate the liability (obligation) for benefits associated with past services; and

3) The number of years used to fund any pension deficit.

Historically, the Companies have been allowed to recover costs that would cover minimum required contribution under federal law while maintaining a certain funded position (maintain 85% AFTAP) to avoid restrictions on payment options available to participants. Effective in 2008, the PPA established new principles for funding pension liabilities:

1) Benefit accruals and liabilities should be based on current market assumptions. Namely, future projected benefit payments should be discounted to today using prevailing yields on high quality corporate bonds;

2) Any shortfall should be funded over seven years; and

3) Any smoothing should be minimal (PPA allows up to 24 month averaging on assets and interest rates in order to mitigate the impact of large, short-term market movements).

However, in recent years, Congress adopted a number of changes to PPA minimum contribution calculation rules, which artificially reduced the pension liability, reducing required contributions. As a result, funding the new lower minimum required contributions (in accordance with the Companies' Commission-authorized methodology) has contributed to the significant current pension deficits. At the same time, legislation simultaneously increased variable rate premiums due to the Pension Benefit Guaranty Corporation (PBGC) which charge the plan a percentage of the unfunded pension liability, significantly increasing the cost of carrying a deficit. The combined impact of those legislative changes was less funding and a higher deficit, which in turn results in larger PBGC variable rate premiums and a higher cost of carrying such a deficit.

The Companies proposed a simple solution to this problem. Rather than make significant changes which would fundamentally transform the long-standing mechanics of pension recovery, the Companies propose a simple modification to the actuarial basis used in calculating pension contributions to the Service Cost (new benefit accruals) and Projected Benefit Obligation (PBO, obligation for previously provided benefits) under Subtopic 715-30 of the FASBASC 715-30. This aligns with PPA's original intent of funding the pension obligation based on market interest rates over a seven-year period. The Companies' proposed methodology change would base rate recovery for pension costs on projected amounts, rather than an annually updated calculation, to add predictability and stability to the pension recovery amounts. In addition, to protect ratepayers from overfunding the plan, the Companies included an annual ceiling to the calculation to make sure contributions would be reduced (and under some circumstances suspended) before excessive overfunding is created.

After careful review, ORA does not oppose the proposed change in methodology.

> ORA examined both company's requests for TY 2019 rate recovery and conducted an independent analysis of their supporting workpapers, responses to data requests, and other discovery. ORA does not take issue with either SoCalGas' or SDG&E's pension benefits expense or methodology change requests.[19]

[19] Ex. ORA-22 (Hunter) at 37.

ORA also supports the continuation of the two-way balancing account.[20]

In its testimony, TURN challenges the Companies' proposal. First, TURN recommends that future recovery be based on GAAP Pension Expense. This approach has two fundamental flaws under the current circumstances. First, using GAAP Pension Expense prospectively fails to recognize the current funded position of the plans (this approach would have more merit if we were establishing a mechanism at the inception of the plans). On a combined basis for SoCalGas and SDG&E, more than $300 million of the current pension deficit <u>will not</u> be recognized in future GAAP Pension Expenses. TURN does not propose any mechanism to address this issue. Second, GAAP Pension Expense can be negative; however, legislation prohibits plan assets from being returned to ratepayers in this situation. Such an arrangement could result in overcollection from ratepayers, as they would reimburse all positive GAAP Pension Expenses, but not receive benefit from the negative amounts. For those reasons alone, TURN's proposal should be rejected.

TURN also claims that the Companies have inappropriately increased pension benefits as evidenced by the settlement accounting charges recognized in the Companies' financial statements ($16 million in 2016 for SDG&E and $30 million in 2017 for SoCalGas), and argues that the Companies should be required to make additional unreimbursed contributions to compensate the plans:

> First, the companies contributed to the PBO shortfall through discretionary unauthorized retirement incentive payments that *increase the PBO* and are hidden from the Commission's review. As a result, shareholders should contribute to the plans a total of $30 million (for SoCalGas) and $16 million (for SDG&E) over the three-year term 2019-2021, above the authorized ratepayer contribution.[21]

TURN's claim is factually incorrect. The settlement accounting charges stated do not represent the value of any pension benefit enhancement. Rather, they represent an acceleration of costs (related to deferred losses on accrued benefits associated with past service) that would otherwise be included in future GAAP Pension Expenses. The fact that benefit payments were accelerated does not affect the pension deficit as those payments reduce the PBO and plan assets

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[20] Ex. ORA-22 (Hunter) at 37.

[21] Ex. TURN-6 (McGovern) at 4 (emphasis added).

by the same amount, leaving the pension deficit unchanged. TURN's claim is based on an inaccurate understanding of the facts, and this request from TURN should therefore also be rejected.

TURN also suggests that the Companies' shareholders should fund 20% of any amount required to be funded by law in excess of the GAAP Pension Expense. Its justification is that the Companies have voluntarily underfunded their pension plan. It is important to remember that the Companies' historical funding methodology has been reviewed and determined to be reasonable by the Commission in General Rate Case (GRC) proceedings, and is not at the Companies' sole discretion, as TURN contends.

Finally, Shippers suggest that the current pension cost methodology is appropriate and should not be changed, but requests that if a change is made, the amortization period should be 21 years, rather than the 7 years proposed by the Companies. The suggestion of 21 years is based on the number of years between the average age of a SoCalGas participant and the plan's normal retirement age of 65. This position fails to take into account that under the plan, a participant's full benefit can be paid as a lump sum upon termination of employment, which can be significantly sooner than age 65. It also fails to recognize that the unfunded liability is for past years of employment (a portion of which is for former employees and retirees), and therefore, related benefits were received by prior customers. The longer those costs are delayed, the greater the generational equity issue becomes.

IV. REBUTTAL TO PARTIES' PROPOSALS

A. Primary Recovery Basis for Pension Costs

1. ORA

ORA does not take issue with the Companies' proposal.

2. TURN

TURN recommends that future pension cost recovery be based on GAAP Pension Expense as defined under ASC 715-30, rather than the alternative funding method proposed by the Companies of funding the service cost plus a seven-year amortization of the unfunded PBO. Under each approach, either TURN's or the Companies', annual contributions would be subject to the minimum of the ERISA minimum required contribution (as modified by PPA) or, if greater, an amount necessary to maintain an 85% AFTAP.

TURN's proposal would result in a fundamental shift from historical practice in how the Companies recover pension costs. In contrast, the Companies' proposal focused on retaining the main principles approved in prior GRC decisions: pension contributions should cover the value of benefits provided to employees for service during the period, plus an amount to fund any pension deficit over a reasonable period of time. While arguments could be made for different "reasonable" periods, PPA defined a reasonable period as seven years, which the Companies used in developing their proposal.

Funding Pension Obligations

Over time, pension contributions along with investment earnings must be sufficient to cover all benefits to be paid from the plan, plus ongoing operating expenses. Operating expenses include PBGC premiums, which are paid annually from pension plan assets. PBGC premiums include a flat rate premium equal to a fixed dollar (indexed each year) for each participant, plus a variable rate that is equal to a percentage (also increasing annually) of the plan's unfunded liability measured based on assumptions prescribed by the PBGC, and which intend to approximate current economic conditions. The variable rate premium is subject to a per-participant dollar cap.

Because pension benefits are earned by an employee while actively working but will not be paid until the employee retires, there are a number of reasonable methods to allocate those costs to each period. While this may appear as merely a "timing issue," actual funding patterns will affect the ultimate costs. Deferring funding to future periods will increase total costs as:

- Assets cannot be invested and the loss of investment returns will have to be made by future contributions. This is similar to carrying a debt (think about a mortgage) where making additional principal payments reduces the total cost of paying off the debt.
- PBGC variable premiums increase the cost of carrying a deficit. PBGC premiums reduce plan assets and those assets, along with lost investment returns, will have to be made up with future contributions, increasing overall costs. The larger the deficit, the larger the PBGC variable premiums (subject to the cap).

In the current context, the key objectives of a funding policy should be as follows:

- Satisfy any legal requirements;
- Minimize long-term costs of paying for the pension benefit;

- Protect intergenerational equity by aligning costs with the services rendered to customers, and limit the extent to which costs are deferred; and
- Mitigate burden on current customers, which implies funding any shortfall over a reasonable period rather than all at once.

GAAP Pension Expense as the Basis for Recovery

ASC 715-30 defines how a company is required to recognize the costs of pension benefits in its financial statements for GAAP purposes (please see Appendix I for detailed background on pension accounting under ASC 715-30). The purpose of the GAAP Pension Expense is to allocate the costs of pension benefits to the various periods of employment. When starting from the inception of a plan, GAAP Pension Expense can be a reasonable way to allocate the cost of pension benefits to specific periods. However, given that this is not the case, and given current circumstances, TURN's recommendation has several serious flaws.

a. TURN's Recommendation Partially Ignores Current Deficit.

The long-term uncertain nature of a pension plan requires actuarial estimates to be made in determining the pension costs. Each year, those estimates are updated to reflect new information and actual experience. To the extent actual experience is different from expectations, the differences (referred to as gains or losses) are quantified and tracked to be recognized in future GAAP Pension Expenses. At any point in time, the amount of unrecognized gains or losses is equal to the sum of historical gains and losses, minus any portions of those gains or losses recognized in prior period GAAP Pension Expenses. There is also a similar adjustment for plan changes referred to as Prior Service Cost/(Credit) (PSC). As of December 31, 2017, the two pension plans were in the following position (in millions):

	SoCalGas	SDG&E
1. Unfunded PBO	$767.6	$162.9
2. Unrecognized Losses and PSC	$465.5	$161.6
3. (Unfunded PBO) minus (Unrecognized Losses and PSC), or Unfunded PBO that will not flow through future GAAP expenses	$302.1	$1.3

This means that TURN's proposal would ignore a combined $303.4 million in existing unfunded pension obligation from future pension recovery. That amount was already recognized in prior years GAAP Pension Expenses, but was not part of the recovered amounts.

Therefore, should the Commission accept TURN's recommendation of using the GAAP Pension Expense as the basis for pension cost recovery prospectively, it will also have to identify a mechanism for additional recovery of this $303.4 million, something TURN did not address in its testimony.

b. TURN's Recommendation Misapprehends the Impact of a Negative GAAP Pension Expense.

When a plan becomes well-funded or experiences significant gains, the GAAP Pension Expense can be negative, resulting in *pension income*. This can cause significant problems when using the GAAP Pension Expense as the basis for pension contributions, because pension assets cannot be taken out of the pension trust (other than to pay benefits or plan expenses) until all benefit obligations have been satisfied. TURN may have overlooked that fact based on the following excerpt from its testimony: "… if the plan is ever over funded … pension expense would start to move close to zero (and sometimes negative), allowing the FVA to come down to PBO."[22] In other words, TURN implies that a negative pension expense would reduce assets (via a refund of contribution), but pension laws prohibit this. Under TURN's approach, rate recovery would equal the GAAP Pension Expense when positive, and $0 when negative (assets cannot be taken out of the plan and therefore not returned to customers). This could result in overfunding of the pension plan, and corresponding overcollection from ratepayers.

c. TURN's Recommendation Fails to Recognize that the Amortization Period for GAAP is Inconsistent with Minimum Funding.

For GAAP Pension Expense purposes, experience gains and losses are amortized over the average future service of active employees. For 2017, those periods were 13.86 years for SDG&E and 15.42 years for SoCalGas. Those periods are significantly longer than the seven years used for minimum funding requirements. As a result, TURN's approach would likely create a mismatch between GAAP Pension Expenses and minimum required contributions. When that happens, the minimum required contribution would prevail and additional funding

[22] Ex. TURN-6 (McGovern) at 39.

would ensue. This creates an even larger discrepancy between actual funding and the GAAP Pension Expense. Tracking and recording differences would add even more complexity to an already complex process, and add to the problems associated with use of the GAAP Pension Expense as the primary basis for recovery. By focusing on cash contributions only, the Companies' proposal naturally avoids those issues.

d. TURN's Recommendation Fails to Recognize that GAAP Pension Expense Can Be Quite Volatile, as It Must Include Settlement and Other Special Accounting Charges.

In its testimony, TURN describes the GAAP Pension Expense as the service costs, plus interest cost, minus expected return on assets, plus amortization of prior service costs, plus amortization of gain or loss.[23] While this accurately describes the basic ongoing expense, TURN's description fails to recognize special accounting costs. GAAP rules recognize that the basic GAAP Pension Expense will not always appropriately reflect pension costs[24] (another argument against this approach). In certain situations, special adjustments must be made. One of those adjustment takes place in case of settlements (there are also adjustments in case of curtailments or special termination benefits – please refer to Appendix I for more details). When a material portion of the plan obligations is settled (for example, when total lump sum distributions in a year exceeds a certain threshold), GAAP requires that a proportional share of unrecognized gains or losses be immediately recognized, rather than amortized in future GAAP Pension Expenses. It is not an additional cost, but simply accelerated recognition of an otherwise future cost.

Given that both SoCalGas and SDG&E plans offer lump sum distribution as an available form of payment, settlements are a regularly occurring aspect to the pension plans. In years

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[23] Ex. TURN-6 (McGovern) at 12:

GAAP Pension Expense = service cost

+ interest cost

- expected return on plan assets

+ amortization of prior service costs

+ amortization of gain or loss.

[24] The components of Net Periodic Benefit Cost (which TURN refers to as "GAAP Pension Expense"), as specified under ASC 715, are described in Appendix I, at 31-35.

where enough participants leave or retire and elect a lump sum distribution, such that total lump sums paid exceed the threshold, accelerated cost recognition will be triggered. If there were a move to GAAP Pension Expense as the basis for future recovery, those settlement accounting costs would have to be added to the recoverable cost and reimbursed via the two-way balancing account. Ignoring this component would purposely exclude pension costs from the recovery mechanism and unfairly relieve ratepayers of a portion of their obligation.

Lump sum elections are at the participants' discretion and the Companies have little to no control on this. Therefore, changing pension recovery to the GAAP Pension Expense, which would have to include settlement charges, would subject ratepayers to significant cost volatility.

3. Shippers

Both TURN and Shippers suggest that if SoCalGas' proposes to base pension cost on service cost plus amortization of unfunded PBO, the amortization period should be extended from the seven years proposed by the Company. TURN proposes 20 years and Shippers 21 years. While TURN does not provide rationale for its selection of 20 years, Shippers' proposed 21 years is based on the difference between the plan's normal retirement age of 65, and the average age of SoCalGas' active participants of 44.

Benefits Can Be Paid Before Age 65

The pension plans of the Companies allow participants to receive the full value of their pension benefit as a single sum upon termination of employment. Therefore, even if one agreed with spreading the deficit for past service (unfunded PBO) over future employment service, future service should be calculated as time until expected termination of employment, not age 65. As mentioned in a previous section, for 2017 this was 15.42 years for SoCalGas and 13.86 years for SDG&E.

Current Unfunded PBO is For Prior Service

The PBO measures the value of pension benefits earned by plan participants for years of employment service rendered in the past, including the benefits of terminated employees and retirees. So, while some participants will continue to work for several years in the future, the customer benefit associated with that obligation was already received. The longer into the future payments for the unfunded portion of the PBO is extended, the larger the disconnect between the customer who pays and the customer who received the benefit of those employees' labor. Therefore, a reasonable but shorter amortization period is more in line with generational equity.

Consistency with Minimum Funding Rules

While arguments could be made for different periods for the amortization of the PBO shortfall, PPA defined a reasonable period as seven years. Therefore, rather than establishing a different arbitrary period, the Companies proposed utilizing the same seven-year period dictated by PPA. This has the added benefit of retaining consistency with the minimum funding rules.

For these reasons, we believe that basing pension cost recovery on cash contributions continues to be a more transparent and superior method to protect the various interests of ratepayers, participants, and the Companies.

B. Additional Unrecoverable Company Contribution

1. ORA

ORA does not take this position.

2. TURN

TURN contends that the company made unauthorized benefit enhancements to its pension plans, and requests that the Companies make additional contributions above authorized rate recovery of $30 million for SoCalGas and $16 million for SDG&E to compensate the plans.

> Additionally, TURN recommends a shareholder-funded contribution to the plans, over and above the ratepayer contribution recorded in the balancing account, of $30 million for SoCalGas and $16 million for SDG&E, due to the Companies' unauthorized use of the VREP to increase ratepayer obligations through its impact on the PBO component.[25]

The basis for its request is the GAAP settlement accounting charges of $16 million incurred by SDG&E in 2016 and $30 million incurred by SoCalGas in 2017. This is simply inaccurate.

As discussed previously, GAAP requires accelerated recognition of deferred gains or losses when a material portion of the liability is paid out. Both pension plans offer participants the option to receive the value of their pension benefits in a single sum rather than a monthly annuity for their lifetime. Therefore, if in any given year the number of participants electing to receive their pension benefits in a lump sum results in total lump sum payments exceeding a pre-determined threshold (defined by GAAP as the sum of the service cost and interest cost), settlement accounting is triggered. In this case, a proportional share of unrecognized losses must

[25] Ex. TURN-06 (McGovern) at 40.

be immediately recognized in the GAAP Pension Expense. This is a timing impact only. Once recognized, this loss will no longer be included in future GAAP Pension Expense, and therefore future GAAP Pension Expenses will be smaller. It is important to note that these lump sum payments do not increase the pension funding deficit (also referred to as PBO shortfall). Lump sum payments reduce both the PBO and the assets by the same amount, leaving the unfunded PBO (PBO less plan assets) unchanged.

The $16 million (SDG&E) and $30 million (SoCalGas) GAAP settlement charges TURN refers to are the result of participants electing to receive their benefit as a lump sum, as provided by the plan, and not the result of additional pension benefits discretionarily granted by the company. The amount of pension benefits was not affected by the VREP described in witness Debbie Robinson's direct testimony on Pensions and PBOPs.

Because it is based on a factually incorrect premise, TURN's request that the Companies contribute an additional $16 million and $30 million (SDG&E and SoCalGas, respectively) should be rejected.

3. Shippers

Shippers does not take this position.

C. SoCalGas Should Pay for 20% of Required Contributions in Excess of GAAP Pension Expense

1. ORA

ORA does not take this position.

2. TURN

TURN contends that the SoCalGas pension deficit is because: "SoCalGas has underfunded its plan, and contributed to the PBO, through years of masking actual pension expense on their balance sheet and making unknown and non-transparent benefits decision."[26] As a result, TURN requests that "if one of the other limits MRC or 85% AFTAP) is triggered in 2019-2021 due to being higher than the GAAP Pension Expense, SoCalGas should be responsible for paying 20% of the incremental annual amount."[27]

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[26] Ex. TURN-6 (McGovern) at 5.

[27] Ex. TURN-6 (McGovern) at 5.

There are several issues with this position. First, as discussed in the prior section, TURN confuses accelerated timing of GAAP costs with additional costs arising from providing new benefits. Given the apparent misinterpretation of the pension accounting standards, TURN offers no proof to its claim that the company has provided unauthorized improvement to its pension benefits. Second, the pension funding and recovery mechanism is reviewed and approved by the Commission in SoCalGas' GRC proceedings. From a forward-looking perspective, SoCalGas' pension funding and recovery mechanism was deemed reasonable by the Commission, and SoCalGas' contributions were made in accordance with the Commission's decisions.

Lastly, TURN's claim that SoCalGas contributed to the PBO by masking actual pension expenses is simply wrong and shows a lack of understanding of the fundamentals of pension plans. The PBO represents the present value as of today of future pension benefit payments expected to be made attributable to previous years of employment. The actuary measures the PBO at any measurement date based on participant census data, assumptions as to future pay increases, employment patterns, retirement dates, and longevity among other things. Past GAAP Pension Expenses, or past contributions and investment returns for that matter, have no impact on the PBO. Therefore, when TURN defines the PBO as the sum of prior pension expenses,[28] TURN is factually incorrect. TURN is also factually incorrect when it states that "[t]he forecasted obligations that are reflected in the value of the PBO in this case have accumulated over many years, and are the result of a major recession, decades of minimal funding, …" [29] Also see Appendix I for more details on the how the PBO is determined, and the relationship between GAAP Pension Expense, contributions, investment returns and PBO.

3. Shippers

Shippers does not take this position.

D. TURN's Secondary Recommendation to Require the Companies to Cover 10% of the Shortfall Payment if the Commission Adopts the Companies' Proposal Is Based on the Same Flawed Arguments Supporting TURN's Primary Recommendation.

1. ORA

ORA does not take this position.

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[28] Ex. TURN-6 (McGovern) at 16.

[29] Ex. TURN-6 (McGovern) at 3.

2. TURN

TURN recommends that if the Commission "allows the Company to use "service cost plus seven-year amortization of the PBO shortfall", then […] the Company cover 10% of the actual shortfall amount each year that is embedded in the contribution calculation due to various policies and actions of the Company that have contributed to the shortfall."[30]

First, we have already explained how TURN's claim of the Companies' improperly provided benefit increases resulted from TURN's misunderstanding of pension accounting rules. Its position also fails to recognize that historical pension funding was based on the Commission approved amounts, and not arbitrary decisions from the Companies.

Second, via the Total Compensation Studies, which have been consistently performed in recent GRC proceedings, the Companies have demonstrated that the pension benefits it provides to its employees are an integral part of a total compensation package, which has been demonstrated to be at market. It has been the Commission's historical policy that the Companies should receive reimbursement for the full cost of compensation and benefit programs for rank and file employees, if those programs are demonstrated to be fair and reasonable.

3. Shippers

Shippers does not take this position.

V. CONCLUSION

To summarize, TURN's proposed alternative basis for recovery, namely Pension Expense under ASC 715, is flawed as a prospective basis for recovery, given that there is more than $300 million of current pension deficit that would <u>not</u> be recognized. Additionally, if GAAP Pension Expense is negative, federal pension regulations prohibit the removal of assets from pension trusts until benefit obligations have been satisfied thus ratepayers would not receive benefits from negative amounts. TURN's claims that the Companies have made unauthorized retirement incentive payments and unknown benefits decisions that have contributed to the PBO shortfall as evidenced by recent settlement accounting charges under US GAAP is inaccurate.

In addition, TURN's testimony contains a number of factual errors and misrepresentations used in justifying its position. Appendix II further elaborates on those errors.

This concludes my prepared rebuttal testimony.

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[30] Ex. TURN-6 (McGovern) at 5.

VI. WITNESS QUALIFICATIONS

My name is Yannick Gagne. My business address is 2010 Main Street, Suite 1050, Irvine, California, 92614. I am an actuary employed by Willis Towers Watson where I am a Senior Director and Head of Retirement Business for the Southwest. Willis Towers Watson is a leading provider of actuarial and retirement consulting services. We serve as the actuary for a large number of the U.S. Fortune 1000 Utilities, and have provided rate case support and/or testimony in most jurisdictions. Personally, I have provided actuarial and consulting services for more than 20 years, working for more than ten different regulated utilities over the years. During my career, I provided rate case support for filings in California, Hawaii, New Mexico, Oregon, Texas, and Washington.

I received my Bachelor of Science in Actuarial Science from Laval University in Canada. I am a Fellow of the Society of Actuaries and an Enrolled Actuary.

I have previously testified before the Commission.

Appendix I

U.S. GAAP Primer – Pension Accounting

ASC 715 Definitions

Projected Benefit Obligation (PBO)

PBO is a widely accepted measure of a plan's liabilities. The PBO is an estimate of the present value of expected future benefit payments, attributable to service accrued as of the measurement date, using actuarial assumptions selected by the Company to model projected salary levels, timing of benefit payments, form of benefit payment (annuity payment or single lump sum), longevity post-retirement, etc.

The PBO is the sum of all future expected benefit payments discounted back to the measurement date, reflecting the time-value of money, where the discount rate is based on current market yields on high quality bonds. The discount rate selected by the Company is based on Securities Exchange Commission (SEC) guidance and reviewed for reasonableness by a number of independent parties such as corporate auditors and the plan actuary.

Other actuarial assumptions are based on a variety of sources, including recent experience and known events, but can also be based on outside sources where the plan's experience is not credible.

Actuarial assumptions are governed by industry published Actuarial Standards of Practice and are disclosed in the valuation report. Significant assumptions are noted on the company's SEC Form 10-K.

Funded Status

The excess of PBO over fair value of assets (FVA) for underfunded plans is reported on the balance sheet as a Pension Liability. For overfunded plans, the excess of assets over PBO is reported as a Pension Asset.

Deferred Costs

Changes in Funded Status attributable to plan changes and actuarial gains and losses are generally not recognized in cost in the current period, but rather, are recognized in future periods as deferred costs. Deferred costs occurring during the year are recorded to Accumulated Other Comprehensive Income (AOCI) and amortized in future periods. Separate accounts in AOCI are maintained for plan changes (Prior Service Costs) and gains and losses (Unamortized Gains/Losses). Additional details regarding deferred costs are detailed under the section below regarding Net Periodic Benefit Cost (also referred to as GAAP Pension Expense). Amortization schedules are included in the actuarial valuation report.

<u>Progression of Funded Status and Deferred Costs</u>

The following illustrates the progression of the Pension Liability and deferred cost accounts that occur during the year (illustration assumes underfunded plan). Service cost, Interest cost, Expected Return on Assets, Gains/Losses are defined further in the section below regarding Net Periodic Benefit Cost.

Progression of PBO is as follows:

$\boxed{\text{PBO}_x}$ + Service Cost + Interest Cost - Benefit Payments ± Plan Changes & Other = $\boxed{\text{Expected PBO}_{x+1}}$ + Current Period PBO (Gains)/Losses = $\boxed{\text{Actual PBO}_{x+1}}$

Progression of FVA is as follows:

$\boxed{\text{FVA}_x}$ + Expected Return on Assets + Contributions - Benefit Payments ± Other = $\boxed{\text{Expected FVA}_{x+1}}$ + Current Period FVA Gains/(Losses) = $\boxed{\text{Actual FVA}_{x+1}}$

Progression of Pension Liability recorded on balance sheet (excess of PBO over FVA) algebraically results in:

$\boxed{\text{Pension Liability}_x}$ + Service Cost + Interest Cost - Expected Return on Assets - Contributions ± Plan Changes & Other = $\boxed{\text{Expected Pension Liability}_{x+1}}$ + Current Period (Gains)/Losses = $\boxed{\text{Pension Liability}_{x+1}}$

Progression of Prior Service Costs is as follows (assumes no special accounting events, discussed later):

$\boxed{\text{Prior Service Cost}_x}$ + Current Period Plan Changes - Amortization = $\boxed{\text{Prior Service Cost}_{x+1}}$

Net Periodic Benefit Cost is the sum of the shaded elements

Progression of Unamortized Gains/losses is as follows:

$\boxed{\text{Unamortized (Gains)/Losses}_x}$ + Current Period (Gains)/Losses - Amortization - Settlement Costs = $\boxed{\text{Unamortized Gains/Losses}_{x+1}}$

Observations

- Benefit payments, including settlements, during the period have no impact on Pension Liability as PBO and FVA impacted equally.
- Contributions affect the Pension Liability, but have no net impact on Company's net value as there is offsetting reduction in cash.
- Pension Liability (not PBO), less deferred costs, is algebraically equivalent to cumulative prior Net Periodic Benefit Costs less cumulative prior contributions.

"Other" includes

- Acquisitions and divestiture
- Plan-to-plan transfers of PBO and FVA
- Curtailment effects

Net Periodic Benefit Cost (NPBC)

This summary pertains to recognition of NPBC. ASC 715 specifies that the NPBC is comprised of five basic recurring components, namely:

1) Service Cost;
2) Interest Cost;
3) Expected Return on Assets;
4) Amortization of Prior Service Cost; and
5) Amortization of Unamortized (Gain)/Loss

In addition, ASC 715 requires recognition in NPBC for the following special accounting events resulting in one-time cost recognition:

6) Settlements
7) Curtailments
8) Special Termination Benefits

The components of NPBC are described below.

1) Service Cost
   - Present value of the benefits expected to be earned during the year based on the same assumptions and methods used to determine the PBO.
2) Interest Cost
   - Increase in the PBO due to the passage of one year's time (similar to a financing cost of a debt).
3) Expected Return on Assets
   - The Company's overall costs are reduced by expected earnings on assets during the period based on an assumed rate of return.
   - The expected return assumption is selected by the Company based on the asset allocation of the trust, long-term return expectations of the various asset classes held by the trust and in Sempra's case, includes an allowance for administrative expenses paid by trust assets.
   - Any difference between the expected return on assets and the actual return on assets is recognized through gains and losses (see item 5 below).
   - For this purpose, assets are the market-related value of assets (market-related assets are the fair value of assets for SDG&E and a three-year smoothed asset value for SoCalGas).
4) Amortization of Prior Service Cost
   - Prior service costs are increases or decreases in the PBO due to a plan change.

- Prior service cost bases are established for each significant amendment and tracked separately as individual prior service cost bases.
- Each prior service cost base is amortized in future NPBC, on a straight-line basis over the average remaining service lives of active employees expected to receive benefits at the time of the amendment.

Illustration of amortization of prior service cost:

Plan Change Increasing PBO
($millions)

a.	Change in PBO attributable to plan amendment	$24
b.	Average expected years of future service at adoption of plan change	12
c.	Annual amortization (straight-line over average future service) [a ÷ b]	$2

Amortization schedule for future net periodic benefit costs

Year	Annual Amortization	Balance at Year-end
1	2	22
2	2	20
3	2	18
*	*	*
*	*	*
11	2	2
12	2	0
Total	24	

5) Amortization of Unamortized Gains/Losses

- Actuarial gains and losses are changes in the amount of either the PBO or the plan assets different from expectations. Examples include:
  - Asset returns being more or less than the expected return assumption,
  - Salary increases being more or less than anticipated,
  - Employees retiring at different ages than expected, retirees living shorter or longer than expected,
  - Various other unpredicatable factors.
- Gains and losses also include any change in PBO due to assumption changes. The most common example is the change in discount rates from year to year.
- If cumulative unamortized gains/losses as of the measurement date are greater than a "corridor" amount, a portion of unamortized gains/losses outside the corridor are recognized in the current year.
  - The portion of unamortized gains/losses over the corridor are amortized over average remaining service (or lifetime for a plan with primarily inactive participants).
  - The corridor is 10% of the greater of PBO or assets (for this purpose, assets are market-related value of assets).

- The amortization period is reset annually based on expected future service for the plan population as of the measurement date.

- Once the level of unamortized gains/losses falls below the corridor, no further recognition of unamortized gains/losses is recognized unless there is special accounting treatment (see item 6, Settlement Costs, below as an example) or the level of unamortized gains/losses increases above the corridor.
- Refer to illustration following item 6) Settlement Costs (*Illustration of recognition of Unamortized Gains/Losses with and without settlement*).

6) Settlement Costs

- Settlements are defined as irrevocable actions relieving the plan of future obligations for a participant's accrued benefits. The most common example is a single sum payment of the participant's accrued benefits which relieves the plan of future benefit obligation related to the participant's benefits.
- When cumulative settlements during a fiscal year exceed an ASC 715 defined threshold, a portion of accumulated gains and losses (see item 5 above) are accelerated and recognized in that year's NPBC and, consequently, recognition in future year's NPBC is reduced, all other factors being equal.
  - The threshold is defined as the sum of the service cost (item 1 above) plus interest cost (see item 2 above) components of NPBC for the year in which the settlements occur.
- Settlement costs have no bearing on the amount of benefits due to the participant.
- See Illustration presented on next page (*Illustration of recognition of Unamortized Gains/Losses with and without settlement*).

Illustration of recognition of Unamortized Gains/Losses with and without settlement:

Recognition of Unamortized Gains/Losses
Assumed no future gains/losses and stable plan conditions for illustration purposes

Initial conditions ($millions)

a.	PBO (assumed level all future periods)	$2,462
b.	Assets (assumed level all future periods)	$1,634
c.	Unamortized gains/losses	$418
d.	Corridor = 10% of maximum of PBO or Assets [max(a, b) x 10%]	$246
e.	Average expected years of future service (assumed stable plan population)	12
f.	Annual amortization (amortization period reset annually) [(c - d) ÷ e]	$14

Future amortization/settlement costs included in net periodic benefit cost

	No settlement accounting		10% of PBO settled in year 5			
Year	Annual Amortization	Balance at Year-end	Annual Amortization	Settlement Cost	Total For Year	Balance at Year-end
1	14	404	14		14	404
2	13	391	13		13	391
3	12	379	12		12	379
4	11	368	11		11	368
5	10	358	10	**37**	47	321
6	9	349	6		6	315
7	9	340	6		6	309
8	8	332	5		5	304
9	7	325	5		5	299
10	7	318	4		4	295
*	*	*	*		*	*
*	*	*	*		*	*
32	1	258	1		1	253
33	1	257	1		1	252
34	1	256	0		0	252
37	1	253	0		0	252
38	1	252	0		0	252
39	0	252	0		0	252
Total	166		129	37	166	

Observation

- Settlement costs do not impact overall recognition of unamortized gains/losses, but rather, impact the timing of recognition.

7) Curtailment Costs

- Curtailment accounting is triggered when there is an event, or series of related events, which significantly decrease future service or benefit accruals. The most common examples are plant closures, reductions in force, benefit freezes and similar events.
- Curtailments can result in gains or losses, depending on the circumstances.
- Curtailment accounting is beyond the scope of this summary, but can result in accelerated recognition of prior service costs (see item 4 above) as well as curtailment costs equal to change in PBO due to the curtailment.

8) Special Termination Benefits

- Special termination benefits are additional benefits paid at separation from service as a result of special events and can be contractual or via plan amendment.
- Examples include additional benefits paid at plant closures and reductions in force.
- Special termination benefits can be different types of additional benefit levels, for example, additional benefits, accelerated vesting or enhanced early retirement subsidies, etc.
- The change in PBO as a result of special termination benefits is recognized immediately as an additional cost in the period in which it occurs.

Appendix II

Summary of Factual Errors or Misrepresentations in TURN Testimony

VII. FACTUAL ERRORS

While reviewing the prepared direct testimony of Jaime McGovern submitted on May 14, 2018 addressing the proposals of San Diego Gas and Electric Company and Southern California Gas Company in their test year 2019 general rate case related to pensions and postretirement benefits other than pensions, on behalf of The Utility Reform Network (TURN), we identified a number of inaccurate statements. The table below lists the information and provides comments on each item.

Statement / Issue	Reference	Comments
"… obligations that are reflected in the PBO in this case have accumulated over many years, and are the result of a major recession, decades of minimal funding, and increases/changes in retirement benefit offerings."	Page 3 at lines 5 - 7	▪ PBO is a measure of the plan obligations and is not affected by asset values. ▪ Therefore, asset losses, such as those resulting from the 2008 recession or insufficient contributions to the pension trust have no impact on the PBO.
"… demonstrated in the Table above [note: Table compares proposed contributions to the GAAP Pension Expense], is that customers should contribute twice as much as that which is being earned by employee service in the given year."	Page 11 at line 3 - 5	▪ The amount earned by employee service is the Service Cost, which is just one component of the GAAP Pension Expense (not the GAAP Pension Expense).
Pension expenses used in Tables 3 and 4 are incorrect	Pages 13 and 14	▪ The amounts shown are not the actual pension expenses for the pension plans as they also include the pension expense for the respective non-qualified plans.
PBO = sum of pension expenses	Page 16 at line 11	▪ Inaccurate; please see Appendix I for more details. ▪ Conclusions drawn in following two paragraphs are based on this false premise and also inaccurate.

PBO shortfall = sum of pension expenses minus FVA (fair value of assets)	Page 21 at line 4	▪ Because the sum of past pension expenses is not equal to the PBO; this is also not accurate.
"If the Commission adopts TURN's proposal to use GAAP Pension Expense as the annual contribution, there is no practical or theoretical need to amortize the PBO shortfall." (internal citations omitted)	Page 21 at lines 22 - 23	▪ Only the portion of the PBO shortfall that has not yet been recognized in prior periods will be included in future GAAP Pension Expenses. ▪ That leaves a combined $303.4 million in unfunded PBO that will never be recovered (see page DR/YG-23 of rebuttal testimony for details).
"For example, the Company provided a voluntary retirement enhancement program (VREP) over the past two years, and the costs of the incentive plan are added to the PBO …"	Page 30 at lines 14 - 15	▪ VREP did not increase any pension benefits; only affected PBOP.
"How can this be true when this caused the Company to record a reduction in 'pension plan assets of … $175 million at SoCalGas in 2017, and $75 million at … SDG&E in 2016'? A reduction in plan assets directly drives down the funded status. These are **exactly** the charges that go into pension expense and/or post-retirement benefit expense via 'amortization of prior service costs' and grow the accumulation of PBO and PBOP." (internal citations omitted; emphasis added)	Page 31 at lines 2 - 6	▪ The $175 million and $75 million are lump sum payments of existing pension benefits due to participants based on the existing terms of the plans. ▪ While assets are reduced, so is the PBO, dollar for dollar. ▪ While the funding percentage (assets divided by liability) may go down, the unfunded amount (PBO minus assets) does not change. - Company proposal of funding the unfunded PBO amount is unaffected. ▪ Those lump sums may trigger settlement charges under GAAP, but those are simply acceleration of future GAAP expenses; timing only, not additional costs.

VIII. INCOMPLETE OR MISLEADING STATEMENTS

In addition to the items above, in its direct testimony, TURN refers to incomplete information to substantiate a point, leaving out some information that would likely change its conclusion. Below is a discussion of some of those items.

Statement / Issue	Reference	Comments
"The Companies forecasted the MRC, including amortization of the entire shortfall, based on values of assets that turned out to be underestimated compared to actual asset values by the first of 2018."	Page 11 at lines 15 - 17	▪ TURN only focuses on half of the equation, the asset component, incorrectly leading one to believe that the Companies are overstating the amounts requested. ▪ The important factor is the unfunded PBO, which is the difference between the PBO and the assets. ▪ While assets outperformed expectations during 2017 (a gain), market interest rates decreased resulting in a higher PBO (a loss). ▪ At the end of 2017, the Companies disclosed the following in their financial statements: - Asset gains of \$73 million and \$167 million for SDG&E and SoCalGas respectively; - PBO losses of \$49 million and \$217 million for SDG&E and SoCalGas respectively; - The net impact is that the unfunded PBO slightly decreased by \$24 million (an improvement) for SDG&E, but increased by \$50 million (a worsening) for SoCalGas.
"However, given the current funding policy, which sets a floor at 85%, by the Companies' own admission the Plan is not expected to be subject to increased premium payments."	Page 26 at lines 14 - 15	▪ TURN here refers to the Companies' comment that if the AFTAP falls below 80%, PBGC premiums will be higher (which is accurate but was not the main point made by witness Robinson). ▪ However, TURN ignores the fact that PBGC variable rate premiums are set as a percentage of the unfunded liability (measured based on PBGC assumptions), subject to the per participant cap. ▪ Therefore (subject to the per participant cap), each additional dollar of deficit will increase PBGC premium (whether or not it reduces the AFTAP below 80%).

		▪ As a result (subject to the per participant cap), each additional dollar of contribution will reduce PBGC premiums. ▪ Therefore, the proposed funding policy will reduce the pension deficit and will result in lower PBGC premiums.
"The companies appear unlikely to have to pay additional premiums throughout the period of this rate case irrespective of whether the Commission adopts the Companies' proposal or TURN's proposal." (internal citations omitted)	Page 27, lines 1 - 3	▪ It is correct that because of the per participant cap on PBGC variable rate premiums, PBGC premium savings are less than $1 million during the 2019 – 2021 period. However, the limited period shown by TURN obscures the long-term value of the Companies' proposal. ▪ First, there is a one year delay between a higher funding contribution and PBGC premium reduction. For example, contribution in 2019 will reduce the funding deficit at January 1, 2020 and consequently reduce the 2020 PBGC variable rate premium. ▪ TURN omits the PBGC premium savings for years 2022 and 2023 which were provided in the Companies response to TURN DR 65-1. Those savings are: - $6.8 million in 2022 and $7.0 million in 2023 for SoCalGas, and - $1.5 million in 2022 and $2.7 million in 2023 for SDG&E.
"In fact, the Companies' forecasts regarding benefits have been inaccurate for years." (Table 11 shows various 5-year forecasts vs. actual benefit payments)	Page 29, lines 14 – 15 and Table 11 on page 30	▪ Because the plans offer a lump sum payment option to most participants, year over year benefit payments are, by nature of the program, unpredictable. ▪ Significant differences from forecasted benefit payments are generally due to more or less lump sums being paid. ▪ However, any differences will affect both the assets and the liabilities (PBO) equally. While the actual PBO and assets can be higher or lower than the forecast, differences in benefit payments will

		not impact the unfunded PBO (PBO minus assets), which is the important factor as the goal is to fund that shortfall.

APPENDIX A

GLOSSARY OF ACRONYMS

Acronym	Definition
AFTAP	Adjusted Funding Attainment Percentage
AOIC	Accumulated Other Comprehensive Income
ASC	Accounting Standards Codification
BY	Base Year
CPUC	California Public Utilities Commission
D.	Decision
ERISA	Employee Retirement Income Security Act of 1974
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FVA	Fair Value of Assets
GAAP	Generally Accepted Accounting Principles
GRC	General Rate Case
I.	Investigation
IRC	Internal Revenue Code
MRC	Minimum Required Contribution
NPBC	Net Periodic Benefit Cost
O&M	Operations and Maintenance
ORA	Office of Ratepayer Advocates
PBGC	Pension Benefit Guaranty Corporation
PBO	Projected Benefit Obligation
PBOP	Pension and Postretirement Benefits Other Than Pension
PPA	Pension Protection Act of 2006
PSC	Prior Service Cost/(Credit)
RAMP	Risk Assessment Mitigation Phase
SDG&E	San Diego Gas & Electric Company
SEC	Securities Exchange Commission
SED	Safety and Enforcement Division

Acronym	Definition
Shippers	Indicated Shippers
S-MAP	Safety Model Assessment Proceeding
SoCalGas	Southern California Gas Company
TURN	The Utility Reform Network
TY	Test Year
VREP	Voluntary Retirement Enhancement Program