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September 10, 2020

VIA FIRST-CLASS MAIL AND ELECTRONIC MAIL

Luly E. Massaro, Commission Clerk
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02888

Re: Docket 5054 - 2020 Pension Adjustment Factor Filing
<u>Response to PUC Request for Supplemental Information</u>

Dear Ms. Massaro:

Enclosed please find one copy of National Grid's[1] response to the Public Utilities Commission's request for supplemental information in the above-referenced matter.

Thank you for your attention to this matter. If you have any questions, please do not hesitate to contact me at (401) 709-3337.

Sincerely,

Leticia Pimentel

Leticia C. Pimentel

Enclosures

cc: Docket 5054 Service List
Leo Wold, Esq.
John Bell, Division
Al Mancini

[1] The Narragansett Electric Company d/b/a National Grid (National Grid or the Company).

Docket No. 5054 - National Grid's Electric 2020 Pension Adjustment Factor Service List as of 8/20/2020

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PUC Supplemental Request

Request:

The Company's response to PUC 1-4 contains a schedule showing the net under/over recoveries for the pension and PBOP reconciliations going back to 2014. For example, for electric, all but one year of the PBOP shows an over collection. Some years were significantly over-collecting (i.e, $3.0 to $5.2 per year). Please discuss why there have been annual over-collections of this magnitude. Please also discuss why the rate allowance upon which the reconciliation is based could not or should not be decreased to avoid future over-collections from ratepayers prior to the next base rate case.

Response:

Overview

In 2008, as part of the first gas rate case after National Grid's acquisition of the Rhode Island gas assets of Southern Union Company, the PUC approved implementation of the Pension Adjustment Mechanism ("PAM") for Narragansett Gas in Docket No. 3943. The PUC subsequently approved the PAM for the Company's electric business in Docket No. 4323, which became effective on February 1, 2013. The PAM reconciles annual pension and postretirement benefits other than pension (PBOP) expense with a base amount established in distribution rates through a base-rate proceeding and allows for recovery of the difference between the base amount and the annual expense amount outside of base rates. PBOP expense is the estimated cost of retiree healthcare benefits and retiree life insurance that will be utilized by employees after they retire from the Company, but are earned during their working years. The implementation and continuation of the PAM has been appropriate because pension and PBOP expense represents a significant operating cost with a high degree of variability not subject to the Company's control. In fact, the nature of the expense that the Company must record to its books in relation to pension and PBOP costs in any given year differs substantially from other expenses incurred to conduct operations. Namely, the Company's ultimate pension and PBOP costs are not fully known until many years in the future, and the associated expense, which the Company must record each year, is, by design, a forward-looking estimation of those future retirement costs. Although the estimation of those future costs (i.e., the annual pension/PBOP expense) is strictly prescribed by applicable accounting rules, the ultimate costs are not known for many years and they must be updated each year for plan experience, and assumptions at the time of measurement are driven by prevailing market conditions. The areas where this dynamic is most visible are the return on plan assets and the discount rate used to determine the present value of future employer paid benefits, both highly susceptible to financial market conditions. Over time, as the experience of the pension and PBOP plans unfolds, the actual cost of these employee benefits is realized. However, the actual cost inevitably varies in some degree from expectations, with the degree of variability largely a function of changing market conditions. The expense calculation requires recognition of those changing market conditions, and as a result, annual expense is highly variable over time. Since it is not possible for National Grid or the Company to exercise direct control over the magnitude and variability of this expense, it has been designed for the expense to be recovered through a reconciling mechanism. A reconciling mechanism addresses the expense variability in a manner that ensures that customers do not pay any more or less than they should over time to support this aspect of electric and gas utility operations.

Analysis of over-collections

As referred to in this supplemental request, the rate allowance for recovery of PBOP expense has exceeded the actual PBOP expense incurred for most fiscal years since Fiscal Year (FY) 2014. Due to the constrained time upon which to respond to this request, the Company's response focuses on over recoveries for the relevant years for the electric PAM only. This analysis does not include the over recoveries for the gas PAM, which is currently pending in the Company's Distribution Adjustment Clause filing in Docket No. 5040, although some of the explanations provided here for the electric PAM over recoveries are also drivers for the gas PAM.

For context, two rate cases have been in effect since 2014. The rate allowances for PBOPs in both of those cases for the electric and gas PAM were fixed for the duration of those rate plans, but the expense is adjusted annually based on actuarial assumptions required by accounting rules. The rate allowance established for PBOP costs in Docket No. 4323 was based on actuarial estimates that were aligned to the Company's rate year ending January 31, 2014. The PBOP rate allowance reflected the most up-to-date actuarial estimates when the Company filed its base rate case on April 27, 2012. The PBOP rate allowance in Docket No. 4323 was based on two months of actuarial projected FY 2013 PBOP costs, and ten months of projected FY 2014 PBOP costs.

Similarly, the rate allowance established for PBOP costs in Docket No. 4770 was based on actuarial estimates that were aligned to the Company's rate year ending August 31, 2019. The PBOP rate allowance reflected the most up-to-date actuarial estimates when the Company filed its base rate case on November 27, 2017. The PBOP rate allowance in Docket No. 4770 was based on five months of actuarial projected FY 2019 PBOP costs, and seven months of projected FY 2020 PBOP costs.

In the preparation of this response, the Company discovered an error in the Electric section of Attachment PUC 1-4 in the amounts reported for FY 2017. In its FY 2017 PAM filing, the

Company reflected a significant true-up of $4.7 million and $3.6 million to credit electric distribution customers for pension and PBOP costs, respectively, that it had been recovering from its affiliate, New England Power Company, since the inception of the electric PAM through its Integrated Facilities Agreement (IFA). While compiling the response to information request PUC 1-4, the Company attempted to normalize the Net Under/(Over) Recovery amounts by excluding this IFA true-up. However, rather than adding back this significant one-time reduction to the actual filed pension and PBOP under/(over) recoveries, it subtracted the true-up amounts, therefore reflecting significant over recovered amounts on Attachment PUC 1-4 for FY 2017. The revised bolded amounts for FY 2017 are shown in the Electric Net Under/(Over) Recovery table below, and reflect the actual filed over/under amounts as reported in its PAM filing in Docket No. 4709 (i.e. not normalized to add back the IFA true-up). This error was only an error in compiling Attachment PUC 1-4 and is not an error with the PAM.

The Narragansett Electric Company - Electric

		Net Under/(Over) Recovery		
Filing Period	RIPUC Docket No.	Pension	PBOP	Total
Feb-13 - Mar-14	4518	$623,723	($503,518)	$120,205
Arp-14 - Mar-15	4518	$1,244,165	($472,489)	$771,676
Arp-15 - Mar-16	4637	$5,665,396	$1,450,222	$7,115,618
Arp-16 - Mar-17	4709	**$2,259,018**	**($9,541)**	**$2,249,477**
Arp-17 - Mar-18	4855	$689,575	($2,987,532)	($2,297,957)
Arp-18 - Mar-19	4958	$2,794,009	($3,127,081)	($333,072)
Arp-19 - Mar-20	5054	$215,299	($5,210,611)	($4,995,312)

After this revision, the only significant PBOP over recoveries occurred in FY 2018, FY 2019, and FY 2020. The rate allowance for PBOPs for FY 2018 (the 12 months ended March 31, 2018) was the rate allowance established in Docket No. 4323. In 2017, the Company negotiated a favorable contract with CVS/Caremark, which resulted in significant savings in prescription drug costs that would not have been known at the time rates were set several years earlier in Docket No. 4323. The approximate reduction to PBOP costs for all of National Grid's US operations was approximately $45 million annually, a portion of which would have benefited customers in Rhode Island.

The PBOP rate allowance for FY 2019 reflected in base rates under Docket No. 4323 for five months of the year, and Docket No. 4770 for the remaining seven months of the year. The reduction in PBOP costs due to the CVS/Caremark contract contributed to a portion of the FY 2019 PBOP over recovery. Also, in preparation of this response, the Company discovered an error in the development in the PBOP rate allowance in Docket No. 4770, which contributed to the FY 2019 PBOP over recovery. The Company calculated its PBOP rate allowance on Page 6 of Schedule MAL-27 in Docket No. 4770. Line 5 of that schedule included a credit of $1.3 million related to reduction in PBOP expense referred to as the Fair Market Value (FMV) amortization adjustment, which relates to a significant gain that existed in the PBOP plan that the Company has been returning to customers over several years related to its acquisition by National Grid in 2000. The summarization of the PBOP rate allowance on Page 6 of Schedule MAL-27 did not include the $1.3 million FMV credit; however, PBOP expense in FY 2019 did include that credit, contributing to the FY 2019 PBOP over recovery. For gas, there existed a significant loss in the PBOP plans when National Grid acquired the Rhode Island gas operations, which it has been charging to customers. The FMV expense amount of $1.6 million was incorrectly excluded from the gas PBOP rate allowances in Docket No. 4770. These FMV balances have been fully amortized or nearly fully amortized for electric and gas as of the current fiscal year and are no longer contributing to an over recovery of PBOP costs for electric, or an under recovery for gas.

As explained in the Company's response to PUC 1-1, the PBOP over recovery for FY 2020 was attributable to favorable claims experience and favorable demographic assumption changes that caused the actual FY2020 PBOP expense to be less than the estimated expense applied in Docket No. 4770, driving the FY 2020 PBOP over recovery. Leading into the March 31, 2019 fiscal year end, the Company's external actuary recommended that the Company perform a study of its PBOP assumption around pre-age 65 PBOP plan participation rates. Participation rates are the rates at which participants elect to participate in the Company's plans. The study concluded that the Company's participants were not electing to participate in the PBOP plans as much as previously assumed, and therefore, this demographic assumption was updated to align with the conclusions of the study. This change resulted in a lower liability and lower FY 2020 PBOP expense. The FMV error described above also contributed to the FY 2020 PBOP over recovery.

The Company is currently reviewing the errors discussed herein and identifying opportunities to establish controls to limit and/or eliminate these types of errors from happening in the future.

<u>Additional Considerations</u>

The Company's PAM for electric and gas have been functioning as designed. Absent the existence of the mechanism, the Company would have retained any over recoveries. The Company is continually looking to find ways to control and reduce PBOP costs where possible, and the PAM is in place to deliver any ongoing PBOP cost reductions back to customers the year after they occur. Furthermore, any over/under recoveries are returned to or from customers in the following year. This is faster than any of National Grid's other electric and gas operating affiliates. In addition, customers or the Company earn carrying charges on over or under recoveries at the customer deposit rate.

As described in the Company's response to PUC 1-3, the impact of COVID-19 on ongoing PBOP expense is uncertain at this time. The amortization of net pension and PBOP investment losses have increased in FY 2021 due to the drop in the value of plan investments at the end of FY 2020 due to the pandemic. While the stock market has temporarily erased some of the investment losses experienced during FY 2020, the impact of investment performance on FY 2022 pension and PBOP expense will not be known until the end of FY 2021. Interest rates are expected to remain very low beyond the current fiscal year. The lower discount rates that have been caused by the pandemic are very likely to result in high pension and PBOP liabilities, which will also likely cause actuarial liability losses and higher service costs than what was included for those components of pension and PBOP costs used to develop the rate allowances for pensions and PBOPs in Docket No. 4770.

The Company does not believe it would be appropriate to adjust base rates at this time to avoid future over collections from customers prior to the next base rate case. In addition to the uncertainty around ongoing PBOP expense described above, the Company is required to file its next electric and gas base rate case no later than November 1, 2021 with new rates expected to go into effect by September 1, 2022, which is relatively near. In addition, PBOP costs are recovered through base rates and it is unusual to change base rates outside of the time frames established in base rate cases.

The Company is open to considering making modifications to the current PAM for effect when new base rates change on September 1, 2022. Modifications might include adopting components of the PAM that are in effect in Massachusetts that would allow for updating projected pension and PBOP costs annually for recovery in the following fiscal year, subject to annual reconciliation and potentially minimize, but not eliminate, significant pension and PBOP over or under recoveries. In addition, this might also include the creation of a separate factor for pension and PBOP costs rather than including these costs in base rates.

Finally, the Company would welcome an opportunity to meet with the PUC and members of the Rhode Island Division of Public Utilities and Carriers, and any other relevant parties in a technical session to discuss how pension and PBOP costs are determined, discuss emerging issues, and answer questions regarding the technical aspects of pension and PBOPs and/or the PAM. The last technical session among the parties on the topic of pensions and PBOPs was held in 2004. This topic is a very specialized and a complex area that warrants periodic opportunities for dialog and discussion.

Prepared by or under the supervision of: Jeffrey Oliveira and James H. Allen