BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Corning Natural Gas Corporation
Case 16-G-0369

October 2016

Prepared Testimony of:

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Q. Please state your name, employer and business address.

A. My name is Sean Malpezzi. I am employed by the New York State Department of Public Service (Department). My business address is Three Empire State Plaza, Albany, NY 12223.

Q. Mr. Malpezzi, what is your position in the Department?

A. I am employed as a Public Utilities Auditor III in the Office of Accounting, Audits and Finance.

Q. Please describe your educational background and professional experience.

A. I graduated from Siena College, Loudonville, New York and have a B.B.A. degree with an Accounting Major. I have been employed by the Department since September of 2005. Previously I was employed as an Auditor for the NYS Credit Union League.

Q. Please briefly describe your responsibilities with the Department.

A. Since joining the Department, my work as a Public Utility Auditor has included examinations of the accounts, records, documents, policies and procedures of regulated utilities with regard to the development of issues in electric, gas, telephone, and water rate proceedings, financings and other general accounting matters.

Q. Have you previously testified before the Commission?

A. Yes, I have testified in several rate proceedings before the Commission including Con Edison Company of New York, Inc. - Case 07-E-0523, New York State Electric & Gas Corporation for Electric and Gas Service Cases - 15-E-0283 and 15-E-0284, and Rochester Gas and Electric Corporation for Electric and Gas Service - Cases 15-E-0285 and 15-E-0285. I have also reviewed municipal rate requests including the Village of Freeport d/b/a Freeport Electric - Case 06-E-0911, City of Plattsburgh Municipal Lighting Department - Cases 05-E-1496 and 08-E-1227, Village of Castile - Case 05-E-1247, Village of Churchville - Case 06-E-0334, and Oneida County Rural Telephone Company - Case 08-C-0610.

Q. Please describe the scope of your examination.

A. In examining Corning Natural Gas Corporation’s filing (Corning or the Company) I compared the historical amounts reported to the Company’s financial records where appropriate and reviewed the assumptions underlying the Company’s rate filing. I also compared the information from the historical test year, the year ended December 31, 2015, with prior periods and examined various material cost elements in order to determine their accuracy and consistency between the test year and projected Rate Year amounts.

Q. Please summarize your testimony.

A. My testimony will address the following items in Corning’s rate case filing: 1) Health Insurance, 2) Uncollectible Expense, 3) the General Allocator, 4) Accumulated Deferred State Income Tax and 5) Building Services Expense.

Q. Did you rely on any information provided by Corning during the discovery phase of this proceeding?

A. Yes. I relied on the Company’s responses to numerous interrogatories or IRs. These IR responses are included in Exhibit __ (SM-1) and are referred to by their numerical designation.

General Inflation Factor

Q. How did the Company calculate its inflation factor?

A. The Company used annual rates of inflation and applied them to the three consecutive periods of December 31, 2015 through May 31, 2016, June 1, 2016 through May 31, 2017 and June 1, 2017 through May 31, 2018 to calculate inflation factors of 1.92%, 1.86%, and 1.80% respectively and totaling 5.69%, inclusive of compounding.

Q. Is this calculation correct?

A. No, in its calculation, the Company used an annual inflation rate for the period of December 31, 2015 through May 31, 2016, rather than a prorated rate for that five month period. This adds seven months of additional inflation to the calculation.

Q. How did you calculate the inflation factor?

A. I used an annual rate of inflation and applied it to the two years and five months in between the end of the historic test year through the forecasted Rate Year. This calculation results in an inflation factor of 4.46%.

Q. What data did you use in your calculation?

A. I used the gross domestic price (GDP) price deflator to calculate the inflation factor of 4.46%. The GDP price deflator uses historical data from the US Bureau of Economic Analysis and the forecasts are from the latest available Blue Chip Economic Indicators.

Q. What is your adjustment based on the general inflation factor?

A. My adjustment reduces O&M expense by $28,267.

Health Insurance

Q. Explain how the Company developed its $773,871 Rate Year forecast of Health Insurance.

A. In the Company Workpaper Update, Exhibit __ (CNG-5), Schedule 6, Page 2 of 2, the Company began with Health Insurance of $581,421 for the historic test year and increased it by 10% for three full years from the end of the historic test year through the Rate Year to arrive at the Rate Year forecast for health insurance expense of $773,871.

Q. Do you agree with the Company’s application of a 10% annual inflation rate?

A. No, I do not. The GDP inflation index reflects a basket of goods and services, including health care services. The application of a separate escalation factor in projecting health care costs is inconsistent with the Commission’s practice, as expressed in Commission Opinion No. 84-27, Opinion and Order Determining Revenue Requirement and Rate Design issued on October 12, 1985 in Case 28695, and reaffirmed in numerous Commission decisions including Opinion 94-3, Opinion and Order Determining Revenue Requirement and Rate Design, issued on February 11, 1994 in Case 92-E-1055. On page 13 of Opinion 94-3, the Commission explains that: “The treatment of medical insurance costs as one factor in a large pool of expenses subject to inflation should produce a reasonable result, because some items will increase at a rate greater than inflation and others at a lower rate.”

Q. Has the Commission used GDP inflation to forecast medical insurance expenses in rate orders?

A. Yes. For example, in the 2008 Electric Rate Order in Case 07-E-0523, Con Edison – Electric

Rates, issued March 25, 2008, the Commission included medical care expenses in the inflation pool. At pages 42-43 of the Order, the Commission stated: “The practice uses the recent costs and the current employee count to capture the present operating conditions.” The Commission also acknowledged that the costs in this and many other categories are expected to increase. Overall, the Company is expected to manage the cost increases in the entire group and to keep them, as best it can, to the general inflation rate.

Q. Why did the Company use a rate of 10%, rather than the general inflator, for health care costs?

A. The direct testimony of Company witnesses Sarhangi and DiValentino states that while the Commission practice “…may have been justified in the distant past when health costs increases were more closely aligned with other costs increases, those days are long gone.” The Company continues that the use of the general inflation factor for health care costs “has become untenable and warrants re-examination based on current circumstances." However, despite the Company's statements to the contrary, the Commission has consistently upheld its position, notably in Case 13-W-0295. In the 2014 Water Rate Order issued on June 26, 2014 in Case 13-W-0295 with regard to United Water New York Inc., the Commission included medical care expenses in the inflation pool. At pages 20-21 of the 2014 Water Rate Order, the Commission stated: "If medical expense falls into the former category, as experience indicates according to UWNY, that does not alter the fact that the general inflation rate is an average of inflationary and deflationary changes in the prices of all the various goods and services in the pool. Thus a deviation between the increase in a single pooled cost item such as medical expense, relative to the average increase, does not justify removing that item from the pool in an attempt to predict it separately. On the contrary pooling of diverse expenses into a single inflation forecast tends to minimize the forecasting errors—and, as noted in the Con Edison decision, the waste of time and resources—that would result from attempting to predict each expense item separately.”

Q. Please explain your adjustment to Rate Year health insurance expense.

A. My calculation of the Rate Year health insurance expense begins with the historic test year expense of $581,421 and applies the general inflation rate of 4.46% from the end of the historic test year through the Rate Year. The results is a period of two years and five months as opposed to the Company’s use of three full years. This forecast results in a decrease to health insurance expense of $166,519.

Uncollectible Expense

Q. Explain the Company’s method of forecasting uncollectible expense.

A. Corning used the net write off method to calculate uncollectible expense. This method divides total revenues by the net accounts receivable write offs for the year to arrive at an annual uncollectible rate. The Company calculated a four-year average of this uncollectible rate of 1.42% and applied this rate to the forecasted Rate Year revenues to arrive at Rate Year uncollectible expense of $188,239.

Q. Do you agree with the Company’s calculation of uncollectible expense?

A. No, I disagree with the Company’s use of a four-year average uncollectible rate to forecast the Rate Year expense.

Q. Explain why you disagree.

A. In 2014, the Company had an unusually large commercial write off. This large write off resulted in an uncollectible rate of 2.44%, which is more than twice the uncollectible rate of the other three years in the Company’s calculation. Based on the 2014 anomaly, a four-year average is skewed, resulting in a much higher rate than three of the four historic years used in the Company’s uncollectible forecast.

Q. Does Corning acknowledge that this was an unusual occurrence?

A. Yes. In response to IR DPS-298, the Company states, “Since 2005, no single write-off of this magnitude has occurred.”

Q. What do you recommend should be used as an uncollectible rate?

A. I recommend using a six-year average uncollectible rate of 1.20%, rather than a four-year average rate. A six-year average is more appropriate based on the occurrence of an unusually large write off only once in the past ten years. The six-year average helps to smooth out the large uncollectible expense anomaly that occurred in 2014 more so than a four-year average does.

Q. Does the data support the use of a six-year average instead of the four-year average?

A. Yes. The uncollectible percentage for the past six years, calendar years 2010 through 2015, were .75%, .75%, .98%, .91%, 2.40%, and 1.12%, respectively. The Company’s use of 1.42% is significantly higher than three of the four years it used in its calculation. By using the six-year average of 1.20% the percentage still exceeds the five of the six years used. The six-year average is still in excess of the uncollectible percentage for 2014 when there was the unusually large commercial write off, and it is close to the uncollectible percentage for 2015, the historic test year.

Q. What is your calculation of Rate Year uncollectible expense?

A. I applied the six-year average uncollectible rate of 1.20% to Staff’s adjusted Rate Year revenues to arrive at a Rate Year forecast of $159,358. This forecast results in a decrease to Rate Year uncollectible expense of $28,881.

Affiliate Allocations

Q. What types of costs did the Company allocate to affiliates in the forecasted Rate Year?

A. As discussed in Staff witness Allison Esposito’s testimony, the Company allocated payroll, payroll associated fringe benefit costs, and various other expenses related to office space and equipment.

Q. Please explain the Company’s affiliate allocation methods.

A. The Company uses three methods for charging costs to affiliates. The first is the direct charge method, under which costs are directly charged to Corning or its affiliates. This method is used when a direct link to the charge is clearly evident. The second method uses various cost causative allocators to assign costs. The third method assigns costs based on a general allocator, which is designed to equitably allocate costs when direct charging or appropriate cost-causative relationships cannot be established.

Q. Please describe Corning's development of its general allocator.

A. The Company uses the Massachusetts Formula for calculating the general allocator. The Massachusetts Formula averages three general components – direct labor distribution, revenues, and utility plant in service. Although this is a commonly used method, many utilities use modifications of this formula to better reflect the companies' individual circumstances. For example, a utility may use net, instead of gross, revenues to eliminate any potential variability in purchased power costs.

Q. Did you find the Company's calculation of the general allocator reasonable?

A. Yes. I reviewed other inputs, such as net revenues, as I previously mentioned, and net plant, and found the results comparable to the general allocator the Company proposed. Therefore, for the purpose of this case, and considering the Company's current affiliates are all regulated utilities, this allocation method appears reasonable. However, to the extent that circumstances change or the Company acquires additional affiliates, in the future Staff and the Commission may need to revisit whether or not this method of calculating the general allocator is still appropriate.

Accumulated Deferred State Income Tax

Q. Did Corning include an adjustment to reflect the effect of the change in the New York State Income Tax rate from 7.1% to 6.5%, effective January 1, 2016, to Accumulated Deferred State Income Tax (ADSIT)?

A. No. In response to IR DPS-248, the Company states that, "The rate change impact on the ADSIT is not included in the testimony and exhibits because the amount is not material."

Q. Do you agree with the Company's exclusion of an

ADSIT adjustment?

A. No. Staff reviewed the Company’s calculation of the ADSIT included in the response to IR DPS-248 which calculates a change in the Deferred Tax Reserve of $7,964. Although it is not a major adjustment, it is important to recognize it as a reflection of the change in the New York State Corporate Tax Rate. This Deferred Tax Reserve change of $7,964 reduces the Company’s revenue requirement by $13,230.

Building Services

Q. Explain how the Company calculated the Accounts Payable Other section of the Building Services Expense?

A. As shown in the Company Workpaper Update, Exhibit __ (CNG-5), Schedule 10, Page 2 of 2, the Company increased the “Accounts Payable Other” costs by the direct labor increases of 2.7%, 12.1%, and 9.9% for the periods January 1, 2016 through May 31, 2016, June 1, 2016 through May 31, 2017 and June 1, 2017 through May 31, 2018 respectively.

Q. Do you agree with the Company’s application of the direct labor increases to the Accounts

Payable Other in Building Services?

A. No. The correct rate to apply to the "Accounts Payable Other" costs is the general inflation rate. This is supported by the Company's Inflation Exhibit __ (CNG-9), Schedule 2 which lists Accounts Payable and Inventory as one of the categories subject to inflation.

Q. What adjustment do you recommend?

A. I recommend an adjustment based on using the inflation rate, which results in a decrease to Building Services Expense of $6,512.

Q. Does this conclude your testimony at this time?

A. Yes.