

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)
UPPER PENINSULA POWER COMPANY)
for authority to increase retail electric rates.)
_____)

Case No. U-16166

DIRECT TESTIMONY AND EXHIBITS OF
CHRISTINE M. PHILLIPS, CPA
FOR
UPPER PENINSULA POWER COMPANY

STATE OF MICHIGAN

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

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

2 A. My name is Christine M. Phillips. My business address is Integrys Business Support
3 (“IBS”), 130 East Randolph Drive, Chicago, Illinois 60601. I am Manager - Benefits
4 Accounting in the Benefits Accounting Department of Integrys Energy Group, Inc.
5 (“Integrys”). Both IBS and Upper Peninsula Power Company (“UPPCO”) are wholly-
6 owned subsidiaries of Integrys.

7

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

9 A. I am providing testimony on behalf of UPPCO.

10

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

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

1 UPPCO.

2

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

4 A. Yes, I have. I have submitted testimony before the Michigan Public Service
5 Commission on behalf of UPPCO in Case No. U-15988, and on behalf of Michigan
6 Gas Utilities Corporation in Case U-15990. I have also submitted testimony before
7 the Public Service Commission of Wisconsin in Docket Nos. 6690-UR-119 and 6690-
8 UR-120.

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

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

2 A. The purpose of my pre-filed direct testimony is to explain the methodologies used to
3 determine UPPCO's forecast of 2011 employee benefit costs.

4

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

6 A. Yes, I am. I am sponsoring Exhibit A-3 (CMP-1), Schedules C28 and C29.

7

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

9 A. Yes, it was.

10

11 **Q. Please describe Exhibit A-3 (CMP-1), Schedule C28.**

12 A. Exhibit A-3 (CMP-1), Schedule C28 is a summary, by sub-account, of employee
13 benefit costs for UPPCO employees for the 2009 historic year, and the 2011
14 projected year, inclusive of UPPCO's allocation of employee benefit costs from IBS.

15

16 **Q. Please describe Exhibit A-3 (CMP-1), Schedule C29.**

17 A. Exhibit A-3 (CMP-1), Schedule C29 is a summary, by sub-account, of IBS employee
18 benefit costs for the 2009 historic year, and the 2011 projected year. This exhibit
19 also calculates UPPCO's allocation of employee benefit costs from IBS.

20

21 **Q. What is the current forecast of employee benefit costs for UPPCO for 2011?**

22 A. The current forecast of employee benefit costs for UPPCO, on a corporate basis, for
23 the 2011 projected year is \$6,947,632, inclusive of UPPCO's allocation of employee
24 benefit costs from IBS. This compares to \$6,191,475 for the 2009 historic year, on a

1 corporate basis. This is an increase of \$756,157 over a two-year period, or 12.2%.
2 This 12.2% increase over two years corresponds to an increase of 5.93% per year.

3

4 **Forecasting Methodologies**

5 **Q. How was the forecast of employee benefit costs for UPPCO for 2011**
6 **developed?**

7 A. As shown on Exhibit A-3 (CMP-1), Schedule C28, UPPCO divided the forecast of
8 employee benefit costs into four categories. These categories were:

- 9 1. Forecasted 2011 costs that are not requested for rate recovery in 2011,
10
11 2. Forecasted 2011 costs that were determined by UPPCO,
12
13 3. Forecasted 2011 costs that were determined by inflating 2009 actual
14 costs, and
15
16 4. Forecasted 2011 costs that were determined through actuarial analysis.

17

18 **Employee Benefit Costs that are Not Requested for Recovery in 2011**

19 **Q. Please describe the forecasted 2011 employee benefit costs that are not**
20 **requested for recovery in 2011.**

21 A. There is one.

22

23 As shown on Exhibit A-3 (CMP-1), Schedule C28, line 1, UPPCO is not requesting
24 recovery in 2011 of any costs recorded in Account 926015, as these costs are
25 related to the Integrys merger, and are not expected to re-occur in 2011.

26

27 **Employee Benefit Costs that were Estimated by UPPCO**

28 **Q. Please describe the process used to determine the forecasted 2011 employee**
29 **benefit costs that were determined by UPPCO estimates.**

30 A. There are three. The total impact of these three items is a net increase of \$601,343
31 from 2009 to 2011.

32

1 First, as shown on Exhibit A-3 (CMP-1), Schedule C28, line 4, regarding the costs
2 recorded in Account 926080 A&G Dental Benefits, UPPCO estimates the 2011 costs
3 to be \$138,683. The overall increase in 2011 costs as compared to 2009 costs is
4 \$9,350. Projected dental costs for 2011 were calculated by using a 5% annual
5 inflation rate. However, the total increase is partially offset by the fact that UPPCO
6 expects to employ fewer employees in 2011 as compared to 2009, as identified in
7 Mr. Seth DeMerritt's Direct Testimony and Exhibits.

8
9 Second, as shown on Exhibit A-3 (CMP-1), Schedule C28, line 5, regarding the costs
10 recorded in Account 926090 A&G Medical Benefits, UPPCO estimates the 2011
11 costs to be \$1,905,185. The overall increase in 2011 costs as compared to 2009
12 costs is \$225,785. Projected medical costs for 2011 were calculated by using an 8%
13 annual inflation rate. However, the total increase is partially offset by the fact that
14 UPPCO expects to employ fewer employees in 2011 compared to 2009, as identified
15 in Mr. Seth DeMerritt's Direct Testimony and Exhibits.

16
17 Third, as shown on Exhibit A-3 (CMP-1), Schedule C28, line 6, regarding the costs
18 recorded in Account 926300 IBS Billed Benefits, UPPCO estimates the 2011 costs to
19 be \$1,186,497. The overall increase in 2011 costs as compared to 2009 costs is
20 \$366,208. The primary drivers behind this increase are higher costs determined by
21 actuarial analysis, higher medical and dental costs for IBS active employees, which
22 were partially offset by the fact that IBS expects to employ fewer employees in 2011
23 compared to 2009, and an increase in UPPCO's cost allocator from IBS, as
24 described in Ms. Tracy L. Kupsh's Direct Testimony and Exhibits.

25
26 **Q. How were IBS employee benefit cost projections calculated?**

27 A. IBS employee benefits cost projections relied on the same assumptions, actuarial

1 analyses, and methodologies used for UPPCO employee benefit costs, as described
2 in this testimony.

3
4 Detail regarding the IBS employee benefits costs is shown on Exhibit A-3 (CMP-1),
5 Schedule C29, line 34.

6

7 **Employee Benefit Costs that were Determined by Inflating 2009 Actual Costs**
8 **Q. Please describe the process used to determine the forecasted 2011 employee**
9 **benefit costs that were determined by inflation.**

10 A. As shown on Exhibit A-3 (CMP-1), Schedule C28, for the sub-accounts shown on
11 lines 10 through 25, UPPCO inflated 2009 actual costs by the inflation factors
12 developed by UPPCO witness Mr. Seth DeMerritt in his Exhibit A-7 (SSD-4). The
13 overall decrease in costs forecasted by inflating 2009 costs to 2011 was \$22,873, or
14 4.6%. This 4.6% decrease over two years corresponds to 2.3% per year.

15

16 **Employee Benefit Costs that were Determined by Actuarial Analysis**
17 **Q. Please describe the process used to determine the forecasted 2011 employee**
18 **benefit costs that were determined by actuarial analysis.**

19 A. As shown on Exhibit A-3 (CMP-1), Schedule C28, for six sub-accounts, UPPCO
20 relied on an actuarial analysis to determine forecasted 2011 employee benefit costs.
21 The specific methods and assumptions employed are described below. The overall
22 increase in costs from 2009 to 2011 forecasted by actuarial analysis is \$190,714, or
23 4.7%. This 4.7% increase over two years corresponds to 2.33% per year.

24

25 The 2011 employee benefit costs that were determined by actuarial analysis are
26 related to:

- 27 1. Employee Sick Leave,
28 2. Employee Pension Expense,

- 1 3. Post Retirement Medical,
- 2 4. Pension Restoration and Supplemental Pension Plan Expense,
- 3 5. Post Retirement Life, and
- 4 6. Long Term Disability Benefit.

5

6 **Employee Sick Leave**

7 **Q. Please describe the development of the employee sick leave expense shown**
8 **on line 28 of Exhibit A-3 (CMP-1), Schedule C28.**

9 A. The Employee Sick Leave expense is determined using actuarial analysis in
10 accordance with Statement of Financial Accounting Standards ("SFAS") No. 87. The
11 plan is only available for UPPCO union and Presque Isle Plant employees. UPPCO
12 was part owner and operator of the plant prior to its sale to Wisconsin Electric Power
13 Company ("WEPCO"). The Plan has frozen hours and rate balances that will be paid
14 at retirement or death. The plan has been frozen since May 1, 1995, and any new
15 hires after 1995 are not eligible to participate in the plan. At retirement or death, a
16 member's current sick time at the frozen rate is compared to their frozen 1995
17 balance, and the lesser amount is paid. For valuation purposes, the sick leave
18 balance paid at the assumed retirement age equals the lesser of:

- 19 1. The May 1, 1995 frozen sick pay balance, or
- 20
- 21 2. The 1995 frozen hourly rate multiplied by the participant's current balance
- 22 of sick pay hours accrued as of the valuation date (or termination date for
- 23 terminated vested participants).
- 24

25 This amount was \$25,929 in 2009, and is projected to be \$24,118 in 2011, which is a
26 decrease of \$1,811.

27

28 **Employee Pension Expense**

29 **Q. Please describe the development of the pension expense shown on line 29 of**
30 **Exhibit A-3 (CMP-1), Schedule C28.**

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

- 8 1. Employee census data,
- 9 2. Current plan provisions,
- 10 3. Plan asset performance, and
- 11 4. Certain other actuarial assumptions.

12

13 For the SFAS No. 87 pension expense, UPPCO’s actuary, Towers Watson
14 (“Towers”), performs the calculations required by this accounting standard annually
15 to determine UPPCO’s pension expense. UPPCO’s external auditors, Deloitte &
16 Touche (“D&T”), review the actuarial assumptions used to ensure consistency with
17 GAAP.

18

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

- 20 1. Service cost,
- 21
- 22 2. Interest cost,
- 23
- 24 3. Expected earnings on plan assets, and
- 25
- 26 4. Amortization of gains and losses, prior service costs, and any transitional
- 27 amounts.
- 28

29 Service cost represents one-year’s pro-rata share of the expected benefits earned
30 during the year by current active employees.

31

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

3
4 There is also an assumption regarding the expected return on assets for the year,
5 which is measured against the actual returns for the period. This rate of return
6 assumption is intended to be a long-term assumption of the return on plan assets.

7
8 The final component represents the amortization of various plan experiences that
9 were not anticipated by actuarial assumptions.

10
11 In order to calculate the plan's total benefit obligation and annual SFAS No. 87
12 expense, the actuary uses a number of assumptions including:

- 13 1. Mortality tables,
- 14 2. Retirement rates from UPPCO,
- 15 3. Anticipated salary increases,
- 16 4. Interest crediting rate, and
- 17 5. Discount rate.

18
19 Integrys management, as well as UPPCO's external auditor, D&T, reviews these
20 assumptions for reasonableness. During the Integrys management review of the
21 SFAS No. 87 assumptions for pension expense, it was recommended by UPPCO's
22 actuary that several assumptions need to be updated to better project expense
23 compared to actual expense. The assumptions that were updated include mortality
24 tables, retirement rates, expected return on assets, and using a spread from the
25 discount rate for the interest crediting rate. These assumption updates are included
26 in the 2011 pension expense. By updating these assumptions, management and
27 UPPCO's actuary believe that projected benefit amounts will better align with actual

1 expense.

2

3 The actuary then calculates the annual SFAS No. 87 pension expense for UPPCO.

4 This amount was \$2,334,856 in 2009, and is projected to be \$2,081,169 for 2011,

5 which includes the assumption changes mentioned above and described below.

6 This is a decrease of \$253,687.

7

8 **Q. Why did UPPCO update the mortality tables used to calculate pension**
9 **expense?**

10 A. The mortality tables used by the actuary to calculate 2009 pension expense was the
11 RP 2000 table projected to 2010. Because it is now 2010, the 2010 table is out of
12 date. UPPCO's external auditor, D&T, will require UPPCO to update the current
13 mortality table. The change to the mortality table increased UPPCO's projected
14 pension expense by \$50,000 for 2011.

15

16 **Q. Why did UPPCO update the retirement rate assumption used to calculate**
17 **pension expense?**

18 A. The current retirement rate assumptions are not in alignment with actual retirements
19 for certain participants, creating actuarial losses year-over-year. An update to the
20 current retirement rate assumption was required to better align the projected and
21 actual retirements. By updating the assumed retirement rates, actual expense will
22 better align with projected expense by reducing the actuarial gain/loss variances that
23 will be smoothed into expense per SFAS No. 87. The change to the retirement rate
24 assumption increased UPPCO's projected pension expense by \$100,000 for 2011.

25

26 **Q. Why did UPPCO update the expected return on assets assumption used to**
27 **calculate pension expense?**

1 A. The expected return on assets (“EROA”) assumption used to calculate 2009 pension
2 expense was 8.50%. The EROA assumption is a long term assumption of average
3 annual return on plan assets. During 2010, Integrys conducted an asset/liability
4 study which resulted in changes to the asset allocation which will be implemented
5 during 2010. Given the changes in the asset allocation, Integrys has determined,
6 through the use of outside consultants, that an EROA assumption of 8.25% is more
7 appropriate. With this change in the EROA assumption, UPPCO will be in the 75th
8 percentile based on a Towers Watson survey of large companies. The change to
9 lower the EROA assumption to 8.25% increased UPPCO’s projected pension
10 expense by \$164,000 for 2011.

11

12 **Q. Why did UPPCO update the interest crediting rate assumption to a spread from**
13 **the discount rate calculation to determine pension expense?**

14 A. During the time period in which an employee stops receiving service credit, and prior
15 to an employee receiving the retirement benefits, the value of the employee's benefit
16 increases each year with the accumulation of an annual interest credit. The actual
17 annual interest credit to participants is based on the first segment rate under the
18 Pension Protection Act of 2006 (“PPA”) from December of the prior year. In the
19 actuarial calculation used to determine the present value of benefits, the assumed
20 interest crediting rate is not used just for the current year, but for the entire time
21 period between the freeze in service accruals for the employee and the assumed
22 retirement age. Given the new plan design, a more accurate interest crediting rate
23 used for valuation purposes would be based on an assumption of how the short end
24 of the yield curve will change over the long-term, as this should more accurately
25 reflect the expected long-term result, rather than basing the assumption on the
26 current interest crediting rate. Based on historical experience of the segment rates,
27 rates for US Treasury securities, and the discount rates, the interest crediting rate

1 has typically had a historical spread from the discount rate of approximately 150
2 basis points. Calculating the interest crediting rate as a spread from the discount
3 rate would create consistency between these actuarial assumptions. Based on its
4 analysis, UPPCO has determined that calculating the interest crediting rate based on
5 a spread from the discount rate provides a better estimate of the present value of the
6 pension benefit obligations due to the long-term nature of the assumptions. UPPCO
7 will begin using a 150 basis point spread from the discount rate in determining the
8 interest crediting rate for projecting pension expense beginning in 2011. The change
9 to the interest crediting rate assumption increased UPPCO's projected pension
10 expense by \$200,000 for 2011.

11

12 **Q. What actions has UPPCO taken to help control pension costs?**

13 A. During 2007, UPPCO made changes to the retirement benefits provided to nonunion
14 employees. The most significant change was a shift from the traditional "defined
15 benefit" pension plan to a "defined contribution" model integrated with the existing
16 401K plan.

17

18 Effective January 1, 2008, the defined benefit pension plan was closed to
19 administrative (non-union) new hires. Those administrative employees participating
20 in the defined benefit pension plan as of January 1, 2008 will continue to accrue
21 pension benefits through December 31, 2012, and the pay rate used in the
22 calculation of pension benefits will be frozen after December 31, 2017. On and after
23 January 1, 2013, all administrative employees will only have an annual contribution
24 made to their 401K account. Employees hired on and after January 1, 2008 will only
25 have an annual contribution made to their 401K account.

26

27 Effective April 19, 2009, the defined benefit pension plan was closed to union new

1 hires. New union employees will only have an annual contribution made to their
2 401K account.

3
4 In addition, on December 31, 2008 the Wisconsin Public Service Corporation
5 Retirement Plan was merged into the Integrys Energy Group Retirement Plan, and a
6 new funding policy was developed. Under the new funding policy, it is the goal to
7 have each Integrys subsidiary in the Integrys Energy Group Retirement Plan to be
8 funded at 105% of the Accumulated Benefit Obligation (“ABO”) over time, and for
9 each subsidiary to reach this goal at approximately the same time.

10
11 Previously, UPPCO only funded an amount equal to SFAS No. 87 annual expense.
12 Under the new policy, UPPCO funded \$7.5 million to the pension plan in 2009 and
13 funded an additional \$16.5 million in 2010. This additional funding will increase
14 UPPCO’s overall working capital and rate base as shown in Mr. Seth DeMerritt’s
15 Exhibit A-1 (SSD-2) Schedule’s B4 and B1, respectively. As a result of the higher
16 contributions to UPPCO’s pension plan, there are higher plan assets. The higher
17 plan assets results in higher expected earnings, thus decreasing pension expense.
18 The increased contribution in 2010 under the new funding policy reduces the overall
19 pension expense by roughly \$1.2 million in 2011.

20

21 **Q. Are other U.S. utilities funding their pension and Other Post Employment**
22 **Benefits (“OPEB”) plans similarly to UPPCO?**

23 A. Yes, they are. In fact, on May 19, 2009, S&P issued a report entitled “Funding
24 Shortfall of U.S. Utility Pension and Postretirement Benefits Adds to Industry’s Cost
25 Pressure Woes.”

26

27 Based on this report, it is clear that many U.S. utilities are funding their pension and

1 OPEB plans similarly to UPPCO. Also, the report highlights the fact that most state
2 regulators authorize rate recovery of the associated costs.

3
4 Due to copyright restrictions, a copy of this report cannot be electronically filed with
5 this case. However, UPPCO will provide a hardcopy of this report to Commission
6 Staff and to the parties in this proceeding.

7

8 **Post Retirement Medical**

9 **Q. Please describe the development of the post retirement medical expense**
10 **shown on line 30 of Exhibit A-3 (CMP-1), Schedule C28.**

11 A. The expense for retirees is determined using actuarial analysis, which is performed
12 in accordance with SFAS No. 106. As stated above, UPPCO follows GAAP for its
13 financial statements. Under the provisions of GAAP, SFAS No. 106 describes the
14 methodologies and assumptions used to calculate and account for retiree health
15 care expense.

16

17 The actuary performs the calculations required by this accounting standard annually
18 to determine UPPCO's SFAS No. 106 expense. D&T reviews the actuarial
19 assumptions used to ensure consistency with GAAP.

20

21 SFAS No. 106 requires an annual determination of the retiree health care expense
22 for the year, also referred to as OPEB expense or Post Employment Benefits other
23 than Pension ("PBOP"). This expense is determined by the actuary each year based
24 upon their review of:

- 25 1. Employee census data,
26 2. Current plan provisions,
27 3. Plan asset performance, and

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4. Certain other actuarial assumptions.

There are four components of SFAS No. 106 expense:

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

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

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

1. Health care inflation trend rates,
2. Mortality tables,
3. Retirement rates from UPPCO,
4. Actual retiree health care claims experience specific to UPPCO, and
5. A discount rate.

Integrus management, as well as UPPCO's external auditor, D&T, reviews these assumptions. During the Integrus management review of the SFAS No. 106 post retirement medical expense assumptions, it was recommend by UPPCO's actuary that several assumptions be updated to better project expense compared to actual expense. The assumptions that were updated include mortality tables, retirement rates, expected return on assets, and the numbers of years to reach the ultimate medical trend rate. These assumption updates are included in the 2011 post retirement medical expense. By updating these assumptions, management and

1 UPPCO's actuary believe that projected benefit amounts will better align with actual
2 expense.

3
4 The actuary then calculates the annual SFAS No. 106 expense component for each
5 year, which was \$1,657,618 for the 2009 historic test year, and is projected to be
6 \$1,942,415 for the 2011 projected test year which includes the assumption changes
7 mentioned above and described below. This is an increase of \$284,797.

8
9 The calculation also reflects UPPCO's acceptance of the government subsidy
10 available under the Medicare prescription drug legislation.

11
12 Also included on Line 30 of Exhibit A-3 (CMP-1), Schedule C28 is expense of
13 \$30,210 for both 2009 and 2011 related to the amortization shown on page 1 of
14 Exhibit A-3 (SSD-1), Schedule C12, as authorized by the Commission's December 8,
15 1992 Order in Case No. U-10040.

16

17 **Q. Why did UPPCO update the mortality tables used to calculate post retirement
18 medical expense?**

19 A. The same mortality table used for pensions is also used for post retirement medical
20 expense. As previously described for pensions, the table used to calculate 2009
21 expense is now out of date. The change to the mortality table increased UPPCO's
22 projected post retirement medical expense by \$50,000 for 2011.

23

24 **Q. Why did UPPCO update the retirement rate assumption used to calculate post
25 retirement medical expense?**

26 A. The retirement rate assumption used for pensions is also used for post retirement
27 medical expense. As previously described for pensions, the assumptions used to

1 calculate 2009 expense were not in alignment with actual retirement experience.
2 The change to the retirement rate assumption had no impact on UPPCO's projected
3 post retirement medical expense for 2011.
4

5 **Q. Why did UPPCO update the expected return on assets assumption used to**
6 **calculate post retirement medical expense?**

7 A. The EROA assumption used to calculate 2009 expense was 8.50%. The EROA
8 assumption is a long term assumption of average annual return on plan assets.
9 During 2010, Integrys conducted an asset/liability study which resulted in changes to
10 the asset allocation which will be implemented during 2010. Given the changes in
11 the asset allocation, Integrys has determined, through the use of outside consultants,
12 that an EROA assumption of 8.25% is more appropriate. With this change in the
13 EROA assumption, UPPCO will be in the 75th percentile based on a Towers Watson
14 survey of large companies. The change to lower the EROA assumption to 8.25%
15 increased UPPCO's projected post retirement medical expense by \$39,000 for 2011.
16

17 **Q. Why did UPPCO update the medical trend rate assumptions used to calculate**
18 **post retirement medical expense?**

19 A. The current medical trend assumption was set in 2007. Historically, UPPCO has
20 been gradually stepping down the medical trend rates to arrive at the ultimate rate
21 5.0% for retirees under age 65, and 5.5% for retirees age 65 and older, by 2013.
22 During review of this assumption, benchmark data from a Towers Watson survey of
23 182 large companies suggests that the ultimate medical trend rates still seem
24 reasonable. However, the time frame to reach the ultimate rates does not seem
25 reasonable based on current expectations that post retirement medical costs will
26 continue to rise, as described further below. As a result, the assumed time frame it
27 will take to reach the ultimate medical trend rates was changed from 2013 to 2016.

1 The assumption change to reach the ultimate medical trend rates increased
2 UPPCO's projected post retirement medical expense by \$100,000 for 2011.

3

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

5 A. Yes, they have. Consistent with the national trend, underlying health care costs for
6 retirees have increased and are projected to continue to increase for UPPCO each
7 year. This trend of higher health care cost increases is expected to continue for a
8 couple of reasons.

9

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

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

- 12 1. The covered population in the health plans is aging and living longer, and
13 therefore use more health services,
14
- 15 2. New, expensive medical technology continues to become available,
16 driving up costs,
17
- 18 3. The government continues to shift costs from government sponsored
19 plans,
20
- 21 4. Provider malpractice liability costs continue to soar, and are reflected in
22 service prices, and
23
- 24 5. New, expensive prescription drugs continue to enter the market,
25 prescription drug prices continue to rise and prescription usage is
26 increasing.
27

28 Second, SFAS No. 106 requires the use of a discounting process to set a value on
29 all future benefit payments. The discount rate is the interest rate selected as of the
30 expense measurement date used to determine the present value of the future
31 outflow of retiree health care payments. The discount rate selected needs to reflect
32 current economic conditions at the time the expense is determined. Lower discount
33 rates create higher expenses under the SFAS No. 106 accounting for expense, as
34 was seen under the SFAS No. 87 accounting for pension expense explained above.

1 A discount rate of 6.05% was used to forecast the 2011 post retirement medical
2 expense.

3

4 **Pension Restoration and Supplemental Pension Plan Expense**
5 **Q. Please describe the development of the executive deferred compensation**
6 **pension equalization expense shown on line 31 of Exhibit A-3 (CMP-1),**
7 **Schedule C28.**

8 A. The Pension Restoration and Supplemental Pension Plan expense is calculated in
9 accordance with SFAS No. 87 accounting rules, identical in nature to the Employee
10 Pension Expense described above. This amount was \$91,194 in 2009, and is
11 projected to be \$74,663 for 2011, which is a decrease of \$16,531.

12

13 **Post Retirement Life Insurance Expense**
14 **Q. Please describe the development of the post retirement life benefit plan**
15 **expense shown on line 32 of Exhibit A-3 (CMP-1), Schedule C28.**

16 A. The Post Retirement Life insurance expense is calculated in accordance with the
17 requirements of SFAS No. 106, identical to the Post Retirement Medical expense
18 described above. This amount was \$49,745 in 2009, and is projected to be \$93,343
19 in 2011, which includes the assumption change described below. This is an
20 increase of \$43,598.

21

22 **Q. Were there any updates to the assumptions to calculate 2011 post retirement**
23 **life expense?**

24 A. Yes, there was. The expected return on assets assumption was updated.

25

26 **Q. Why did UPPCO update the expected return on assets assumption used to**
27 **calculate post retirement life expense?**

28 A. The EROA assumption for 2009 expense was 8.50%. This assumption was

1 changed to 8.25% for 2011 as a result of changes in the asset allocation that will be
2 implemented during 2010 as described above. The change to lower the EROA
3 assumption to 8.25% increased UPPCO's projected post retirement life expense by
4 \$3,000 for 2011.

5
6 **Long Term Disability Expense**

7 **Q. Please describe the development of the long term disability benefit plan**
8 **expense shown on line 33 of Exhibit A-3 (CMP-1), Schedule C28.**

9 A. The Long Term Disability ("LTD") Plan expense is actuarially determined and is
10 performed in accordance with SFAS No. 112. Under SFAS No. 112, benefit
11 obligations are accrued from the date the participant commences benefit payments.
12 Annual SFAS No. 112 expense is based on the benefit obligations calculated using a
13 roll forward of prior year valuation results, adjusted for any plan changes or events.
14 The expense is related to only the participants on the LTD plan prior to April 1, 2008.
15 Benefits under this LTD Plan typically will continue until the earlier of the date of
16 recovery, death, attainment of age 65, or retirement. The actuarially determined
17 SFAS No. 112 expense was (\$140,180) for the 2009 historic test year, and is
18 projected to be (\$5,832) for the 2011 projected test year, an increase of \$134,348.

19
20 **Q. Will UPPCO provide updated actuarial analyses when available?**

21 A. Yes, it will. Upon request, UPPCO will provide an updated actuarial analysis to
22 Commission Staff and to the parties in this proceeding if one is completed during the
23 pendency of this proceeding.

24
25 **Q. Does this complete your pre-filed direct testimony?**

26 A. Yes, it does.

UPPER PENINSULA POWER COMPANY

Summary of Employee Benefits Costs

Test Year Ended December 31, 2011

Line No.	Sub-Account Description	2009 Actual \$	2011 Forecast \$	Increase \$	Increase %	Forecast Method
1	926015 A&G TEG Transition Costs	\$ 13,027	\$ -	\$ (13,027)	-100.0%	Not Requested for Recovery
2	Subtotal - Not Requested for Recovery	\$ 13,027	\$ -	\$ (13,027)	-100.0%	
3						
4	926080 A&G Dental Benefits	\$ 129,333	\$ 138,683	\$ 9,350	7.2%	UPPCO Estimate
5	926090 A&G Medical Benefits	\$ 1,679,400	\$ 1,905,185	\$ 225,785	13.4%	UPPCO Estimate
6	926300 IBS Billed Benefits	\$ 820,289	\$ 1,186,497	\$ 366,208	44.6%	Exhibit A-3 (CMP-1), Schedule C29
7	Subtotal - UPPCO Estimate	\$ 2,629,022	\$ 3,230,365	\$ 601,343	22.9%	
8						
9						
10	926007 Company Match 401K	\$ 208,803	\$ 218,356	\$ 9,553	4.6%	Inflationary
11	926020 Time Away From Work Residual Balance	\$ 1,690,873	\$ 1,768,233	\$ 77,360	4.6%	Inflationary
12	926025 Time Away From Work - Clearing	\$ (1,606,283)	\$ (1,679,773)	\$ (73,490)	4.6%	Inflationary
13	926026 IBS Billed Non Productilve Time - Residual Balance	\$ (24,939)	\$ (26,080)	\$ (1,141)	4.6%	Inflationary
14	926050 Human Resources Dept General	\$ 74,820	\$ 78,243	\$ 3,423	4.6%	Inflationary
15	926070 Christmas Gift Check Expense - Retirees	\$ 5,181	\$ 5,418	\$ 237	4.6%	Inflationary
16	926100 Benefits Expense - Awassa Lodge	\$ 338	\$ 353	\$ 15	4.6%	Inflationary
17	926120 Joint Plant A&G & Non-Utility Loading	\$ (321,908)	\$ (336,636)	\$ (14,728)	4.6%	Inflationary
18	926135 Fully-Insured Long Term Disability Premium Exp	\$ 28,210	\$ 29,501	\$ 1,291	4.6%	Inflationary
19	926140 A&G ESOP Contribution Expense	\$ 158,077	\$ 165,309	\$ 7,232	4.6%	Inflationary
20	926170 A&G Capitalized Pensions and Benefits	\$ (690,933)	\$ (722,544)	\$ (31,611)	4.6%	Inflationary
21	926190 Goal Sharing	\$ (82,554)	\$ (86,331)	\$ (3,777)	4.6%	Inflationary
22	926191 IBS Billed Incentive Residual	\$ 18,067	\$ 18,894	\$ 827	4.6%	Inflationary
23	926200 Employee Benefits Tuition Reimbursement	\$ 927	\$ 969	\$ 42	4.6%	Inflationary
24	926250 Company Provided Life Insurance	\$ 39,176	\$ 40,968	\$ 1,792	4.6%	Inflationary
25	926260 Executive Deferred Compensation ESOP Match	\$ 2,199	\$ 2,300	\$ 101	4.6%	Inflationary
26	Subtotal - Inflationary Items	\$ (499,946)	\$ (522,819)	\$ (22,873)	4.6%	
27						
28	926011 A&G Opererating Employee Sick Leave	\$ 25,929	\$ 24,118	\$ (1,811)	-7.0%	Actuarial Analysis
29	926060 A&G Pension Expense	\$ 2,334,856	\$ 2,081,169	\$ (253,687)	-10.9%	Actuarial Analysis
30	926180 A&G Post Retirement Medical	\$ 1,687,828	\$ 1,972,625	\$ 284,797	16.9%	Actuarial Analysis
31	926210 Pension Restoration and Supp Pension Plan Exp	\$ 91,194	\$ 74,663	\$ (16,531)	-18.1%	Actuarial Analysis
32	926305 Post Retirement Life	\$ 49,745	\$ 93,343	\$ 43,598	87.6%	Actuarial Analysis
33	926315 Long Term Disability Benefit	\$ (140,180)	\$ (5,832)	\$ 134,348	-95.8%	Actuarial Analysis
34	Subtotal - Actuarial Analysis	\$ 4,049,372	\$ 4,240,086	\$ 190,714	4.7%	
35						
36	TOTAL EMPLOYEE BENEFIT COSTS	\$ 6,191,475	\$ 6,947,632	\$ 756,157	12.2%	

UPPER PENINSULA POWER COMPANY

Summary of IBS Employee Benefits Costs

Test Year Ended December 31, 2011

Line No.	Sub-Account Description	2009	2011	Increase	Increase	Forecast
		Actual	Forecast			
		\$	\$	\$	%	
1	926080 A&G Dental Benefits	\$ 886,520	\$ 959,447	\$ 72,927	8.2%	UPPCO Estimate
2	926090 A&G Medical Benefits	\$ 9,544,910	\$ 10,928,823	\$ 1,383,913	14.5%	UPPCO Estimate
3	Subtotal - UPPCO Estimate	\$ 10,431,430	\$ 11,888,271	\$ 1,456,840	14.0%	
4						
5						
6	926007 Company Match 401K	\$ 211,562	\$ 221,241	\$ 9,679	4.6%	Inflationary
7	926016 Commuter Transportation	\$ 13,769	\$ 14,399	\$ 630	4.6%	Inflationary
8	926020 Time Away From Work Residual Balance	\$ 15,114,290	\$ 15,805,789	\$ 691,498	4.6%	Inflationary
9	926025 Time Away From Work - Clearing	\$ (15,548,082)	\$ (16,259,427)	\$ (711,345)	4.6%	Inflationary
10	926026 IBS Billed Non-Productive Time - Residual Balance	\$ 433,792	\$ 453,638	\$ 19,847	4.6%	Inflationary
11	926050 Human Resources Department General	\$ 553,006	\$ 578,306	\$ 25,301	4.6%	Inflationary
12	926070 Christmas Gift Check - Retirees	\$ 3,516	\$ 3,677	\$ 161	4.6%	Inflationary
13	926135 Fully-Insured Long Term Disability Premium	\$ 308,385	\$ 322,494	\$ 14,109	4.6%	Inflationary
14	926140 A&G ESOP Contribution Expense	\$ 4,635,568	\$ 4,847,651	\$ 212,083	4.6%	Inflationary
15	926170 A&G Capitalized Pensions and Benefits	\$ (1,402,648)	\$ (1,466,821)	\$ (64,173)	4.6%	Inflationary
16	926190 Goal Sharing	\$ 408,959	\$ 427,669	\$ 18,710	4.6%	Inflationary
17	926191 IBS Billed Incentive Residual	\$ (491,795)	\$ (514,295)	\$ (22,500)	4.6%	Inflationary
18	926200 Employee Benefits Tuition Reimbursement	\$ 369,396	\$ 386,296	\$ 16,900	4.6%	Inflationary
19	926250 Company Provided Life Insurance	\$ 303,864	\$ 317,766	\$ 13,902	4.6%	Inflationary
20	926260 Executive Deferred Compensation ESOP Match	\$ 15,573	\$ 16,286	\$ 712	4.6%	Inflationary
21	926270 Employee Benefit - Adoption Assistance	\$ 3,000	\$ 3,137	\$ 137	4.6%	Inflationary
22	Subtotal - Inflationary Items	\$ 4,932,154	\$ 5,157,807	\$ 225,652	4.6%	
23						
24	926017 Post Retirement Welfare FAS 106	\$ 960,687	\$ 1,896,246	\$ 935,559	97.4%	Actuarial Analysis
25	906019 Supplemental Employee Retirement Plan	\$ 71,655	\$ 183,109	\$ 111,454	155.5%	Actuarial Analysis
26	926060 A&G Pension Expense	\$ 10,793,281	\$ 14,362,166	\$ 3,568,885	33.1%	Actuarial Analysis
27	926180 A&G Post Retirement Medical	\$ 27,435	\$ 32,081	\$ 4,646	16.9%	Actuarial Analysis
28	926210 Pension Restoration and Supp Pension Plan Exp	\$ 738,224	\$ 941,269	\$ 203,045	27.5%	Actuarial Analysis
29	926220 Supplemental Employee Retirement Plan	\$ 132,662	\$ 489,109	\$ 356,447	268.7%	Actuarial Analysis
30	926305 Post Retirement Life	\$ 901	\$ 1,439	\$ 538	59.7%	Actuarial Analysis
31	926315 Long Term Disability Benefit	\$ 34,672	\$ (54,530)	\$ (89,202)	-257.3%	Actuarial Analysis
32	Subtotal - Actuarial Analysis	\$ 12,759,517	\$ 17,850,889	\$ 5,091,372	39.9%	
33						
34	TOTAL EMPLOYEE BENEFIT COSTS	\$ 28,123,101	\$ 34,896,966	\$ 6,773,865	24.1%	
35						
36	Allocation Percentage from IBS to UPPCO	2.9%	3.4%			
37						
38	Allocation Dollars from IBS to UPPCO	\$ 820,289	\$ 1,186,497	\$ 366,208	44.6%	

