SOCALGAS

DIRECT TESTIMONY OF DAVID SARKARIA

PENSION AND POSTRETIREMENT BENEFITS
OTHER THAN PENSION

November 2014

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA
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SUMMARY

<table>
<thead>
<tr>
<th>O&amp;M ($000)</th>
<th>Base Year 2013</th>
<th>Test Year 2016</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension</td>
<td>56,123</td>
<td>82,090</td>
<td>25,967</td>
</tr>
<tr>
<td>PBOPs</td>
<td>9,034</td>
<td>1,520</td>
<td>(7,514)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>65,157</strong></td>
<td><strong>83,610</strong></td>
<td><strong>18,453</strong></td>
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Summary of Requests

- Maintain Company’s ability to attract and retain the best possible talent by offering a competitive total compensation package including pension and postretirement health benefits

- Continue to recover pension costs based on the greater of the annual ERISA minimum required contribution or the contribution required to maintain a 85% funding ratio

- Continue to recover postretirement health and welfare benefits expense based on costs determined pursuant to Financial Accounting Standard 715-60

- Maintain the long-standing use of the two-way balancing account mechanism for pension and PBOP expenses since expense variability is generally due to external economic and regulatory variables which are outside the control of the Company
SOCALGAS DIRECT TESTIMONY OF DAVID SARKARIA

PENSION AND POSTRETIREMENT BENEFITS OTHER THAN PENSION (”PBOPs”)

I. INTRODUCTION AND SCOPE OF TESTIMONY

I sponsor the Test Year 2016 forecasts for pension and postretirement health and welfare benefits other than pension (“PBOP” or “PBOPs”) provided through the qualified retirement plan and the postretirement benefit plan at Southern California Gas Company (“SCG” or “Company”). Pension and PBOPs are key components of the total compensation package provided to SCG non-represented and represented employees. The Towers Watson Study includes a detailed analysis of “total compensation,” including benefits, as discussed in the direct testimony of Debbie S. Robinson (Ex. SCG-21).

II. PENSION BENEFITS

A. Summary Description

1. Participant Demographics

The SCG Pension Plan (“Plan”), which was first established in 1932, provides benefits to approximately 7,500 active employees and 6,000 retirees, survivors and terminated participants entitled to future benefits. The average age of active employees is 45.5 years with an average of 16.6 years of service. Retirees who are currently receiving benefits average 75.9 years of age.

2. SCG Union Employees

The defined benefit plan for represented employees (the “Traditional Plan”) provides a retirement benefit based on final average earnings and years of service. The minimum service requirement for benefit vesting purposes is five years. The Traditional Plan provides normal retirement at age 65 with five or more years of service and early retirement benefits at age 55 with at least 15 years of service. Employees who retire prior to attaining age 62 receive a reduced benefit unless the sum of their age and credited service equal a minimum of 90.

The normal form of benefit is a lifetime annuity which is actuarially reduced to provide a 50% joint and survivor benefit to a surviving spouse. In addition, several other optional forms of benefit are available, including a lump sum option which is the most prevalent form of distribution.

Effective March 1, 2012, all employees who became subject to the collective bargaining agreement on or after January 1, 2012 became participants in the Company’s Cash Balance Plan, the same plan provided to non-represented employees. Union employees who were covered by

DS-1
the collective bargaining agreement and who were hired on or before December 31, 2011 are grandfathered and continue to accrue and receive benefits under the Traditional Plan.

3. **SCG Non-represented Employees**

Prior to July 1, 1998 SCG non-represented employees participated in the same plan design as the SCG union employees. Effective July 1, 1998, employees began participating in the Cash Balance Plan. Any employee hired prior to July 1, 1998 ("Grandfathered Employee") continued to accrue benefits under the “grandfathered” Traditional Plan (the “Grandfathered Plan”) for a five-year transition period. Benefit accruals under the Grandfathered Plan were frozen as of June 30, 2003.

Participants in the Cash Balance Plan receive retirement credits equal to 7.5% of eligible earnings and interest on their account balances up to the date of distribution. Interest credits are based on the 30-year U.S. Treasury bond rate, which changes annually based on the November average for the immediately preceding year. Special transition retirement credits and interest credits apply for a limited period to certain Grandfathered Employees.

Until March 1, 2007, Grandfathered Employees received benefits equal to the greater of the benefit calculated under the Grandfathered Plan or their benefit under the Cash Balance Plan. On or after March 1, 2007, a Grandfathered Employee’s benefit is the greater of (1) their Cash Balance Plan account balance or (2) their Grandfathered Plan benefit plus their Frozen Benefit Plus+ Account. The Frozen Benefit Plus+ Account is based on retirement and interest credits accrued beginning July 1, 2003 (after the Grandfathered Plan was frozen).

Effective January 1, 2008, participants are 100% vested after three years of service. Although several forms of benefit payment are available, most participants elect a lump sum distribution.

B. **Pension Cost Estimate**

The Company’s actuary, Towers Watson, provides an annual certified actuarial valuation of the Plan that includes the value of benefit obligations and minimum required contributions. The valuations are performed in accordance with generally accepted actuarial principles and practices. Plan expense, as shown in Table 1, is based on minimum required contributions in accordance with the Employee Retirement Income Security Act of 1974 ("ERISA") and as allowed by the Internal Revenue Code ("IRC").
Table 1 – SCG Summary of 2013 vs. 2016 Pension Benefit Expense

<table>
<thead>
<tr>
<th>Cost Center</th>
<th>Benefit Description</th>
<th>2013 Actual</th>
<th>2016 Budget</th>
<th>2013-2016 Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2200-8001.000</td>
<td>Pension</td>
<td>$ 56,123</td>
<td>$ 82,090</td>
<td>$ 25,967</td>
</tr>
</tbody>
</table>

1Reflects current projected minimum pension contribution

C. Test Year Pension Expense

As discussed in the balance of this exhibit, pension contributions are difficult to project with certainty due to the impacts of numerous external variables. Consequently, the current estimated test year contribution of $82.1 million, which is based on the projected ERISA-required minimum, is very likely to change. Any 2016 variance between authorized and actual contributions would be subject to the current two-way balancing account mechanism, as proposed in the Direct Testimony of Reggie Austria (Ex. SCG-33).

D. ERISA Funding Requirements

1. Minimum Required Contributions

Under the Pension Protection Act of 2006 (“PPA”), the minimum required annual contribution is equal to the target normal cost plus amortization of any funding shortfall. The target normal cost is the present value of benefits expected to be earned by participants during the plan year. The PPA established a plan funding target equal to the present value of benefits accrued or earned as of the valuation date (January 1 for the Pension Plan). A funding shortfall occurs when the actuarial value of plan assets falls below the PPA funding target.

Prior to 2009, the Plan had experienced a long period during which Plan assets exceeded liabilities and minimum contributions were not required. Chart 1 shows Plan assets and liabilities for the period 1996 through 2013. As of 2013, the actuarial value of assets is $1.54 billion and continues to improve based on current market performance.
Chart 2 shows contributions and benefit payments during the period 1996 thru 2013. It is important to note how market returns have significantly contributed to the payment of benefit obligations. Over the 18-year period, benefit payments exceeded contributions by over $1.77 billion.

[Remainder of page intentionally left blank]
2. Discount Rates

In addition to market returns, the discount rate used in determining the minimum required funding contribution is another important variable. The Plan uses IRS-prescribed 24-month average bond segment rates. A new effective interest rate ("EIR") is determined each year, on January 1, based on the 24-month average of high-quality corporate bond rates as of the preceding September 1. Beginning in 2012, this 24-month average must fall within a specified range around the 25-year average of such segment rates as discussed in Section II.D.3. The EIR is the single interest rate that produces the same liability that results from using the three distinct segment rates. The IRS also allows an EIR determination using a one-month average yield curve; however, this method lacks the “smoothing” effect of the 24-month average.
3. Impact of Moving Ahead for Progress in the 21st Century and Highway and Transportation Funding Act

Congress enacted the Moving Ahead for Progress in the 21st Century Act (“MAP-21”) which became law on July 6, 2012. The purpose of the legislation was to achieve pension stabilization using a funding interest rate corridor with both a cap and a floor. Given the continued decline in interest rates since MAP-21 was enacted in 2012, Congress enacted an extension of the funding stabilization provisions of MAP-21 in 2014 under the Highway and Transportation Funding Act (“HATFA”). This subsequent legislation, signed into law on August 8, 2014, has the effect of increasing funding interest rates for the plan and lowering minimum contributions over the next few years.

Chart 3 shows the anticipated effect of MAP-21 and the extended effect of HATFA on the EIRs used to estimate minimum contributions in the SCG pension benefit funding forecast discussed in Section G. MAP-21 modified the 24-month average segment rates beginning in 2012 and future plan years so that they will not fall outside a corridor (shown in gray below) which surrounds the 25-year average of such segment rates. HATFA both extends the corridor and delays the widening of the corridor (shown in hatched lines below). The MAP-21 corridor started at 90% - 110% of the 25-year average in 2012 and expanded 5% per year to a corridor of 70% - 130% in 2016 and after was revised under HATFA to remain at 90% - 110% through 2017 before increasing 5% per year to a corridor of 70% - 130% in 2021.

Chart 3 – SCG Pension Plan MAP-21 Effective Interest Rates
The 2013 EIR was 6.31%, which is only slightly higher than the projected 6.08% EIR for 2016 under HATFA. However, both are significantly higher than the 4.34% EIR projected in 2023. Higher EIRs resulted in lower required minimum contributions for 2012 and 2013 as noted in Chart 4 below. Assuming all other variables are constant, a reduction in EIR would increase minimum required contributions.

Chart 4 shows funding projections provided in the 2012 GRC compared to the 2016 GRC with updates for the effect of HATFA. The impact of MAP-21 followed by HATFA resulted in lower contributions than projected in the 2012 GRC. The actual contributions for plan years 2012 and 2013 were $42.8 million and $56.1 million compared to the projected amounts of $110.1 million and $110.7 million. The 2016 GRC projections as updated for HAFTA show a delay in higher contributions until 2016 and then continuing thru 2022 as the impact of HATFA diminishes and full PPA funding levels are gradually attained.

**Chart 4 – SCG Pension Plan Minimum Required Funding Projections:**

**2012 GRC vs. 2016 GRC**
E. Benefit Limitation Threshold

In addition to the minimum required contributions under IRC §412 (pre-2008) and IRC §430 (post-2007), the PPA also established benefit limitation criteria. If the Plan’s funded status falls below 80% (i.e., the ratio of plan assets to the funding target equals 0.8 or less), the plan would be subject to certain benefit restrictions, and potentially higher required minimum contributions and Pension Benefit Guaranty Corporation premiums.

As can be seen in Chart 5, since 1997, the Plan has maintained a funded percentage ratio well above 100% until 2009, when the funded percentage dropped from 116.1% at January 1, 2008 to 87.4% at January 1, 2009. Since then, the funded ratio has improved to 99.6% as of 2013, well above the benefit limitation threshold.

Chart 5 – SCG Pension Plan Actuarial Value of Assets as a Percentage of Funding Target: 1996 – 2013

Given the current state of the Pension Plan, the benefit limitation threshold will probably not impact the distribution of benefits to plan participants in the foreseeable future. However, consistent with the decision in the 2012 GRC, the Company requests that Plan contributions be...
based on the minimum required amount or such amount as required to maintain an 85% funding ratio.

F. Market Returns and Discount Rate

1. Market Returns

Plan assets are managed through a master trust and invested in a diversified portfolio of equity and bond securities. As shown in Table 2, the Plan has experienced very positive returns for the period 2009 thru 2013. During the period, the Plan’s return on assets exceeded the long-term actuarial assumption of 7% in all years except 2011.

Table 2 – Pension Plan Investment Returns: 2004 – YTD March 2014

<table>
<thead>
<tr>
<th>Year</th>
<th>Investment Policy Benchmark</th>
<th>Master Trust Actual</th>
<th>S&amp;P 500</th>
<th>Barclay's Aggregate Bond</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>12.0%</td>
<td>13.0%</td>
<td>10.9%</td>
<td>4.3%</td>
</tr>
<tr>
<td>2005</td>
<td>9.0%</td>
<td>8.7%</td>
<td>4.9%</td>
<td>2.4%</td>
</tr>
<tr>
<td>2006</td>
<td>14.2%</td>
<td>14.9%</td>
<td>15.8%</td>
<td>4.3%</td>
</tr>
<tr>
<td>2007</td>
<td>8.6%</td>
<td>9.2%</td>
<td>5.5%</td>
<td>7.0%</td>
</tr>
<tr>
<td>2008</td>
<td>-27.6%</td>
<td>-26.1%</td>
<td>-37.0%</td>
<td>5.2%</td>
</tr>
<tr>
<td>2009</td>
<td>23.6%</td>
<td>22.2%</td>
<td>26.5%</td>
<td>5.9%</td>
</tr>
<tr>
<td>2010</td>
<td>13.8%</td>
<td>12.9%</td>
<td>15.1%</td>
<td>6.5%</td>
</tr>
<tr>
<td>2011</td>
<td>-0.2%</td>
<td>-0.8%</td>
<td>2.1%</td>
<td>7.8%</td>
</tr>
<tr>
<td>2012</td>
<td>15.1%</td>
<td>15.1%</td>
<td>16.0%</td>
<td>4.2%</td>
</tr>
<tr>
<td>2013</td>
<td>16.5%</td>
<td>16.4%</td>
<td>32.4%</td>
<td>-2.0%</td>
</tr>
<tr>
<td>YTD</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>March</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>2.5%</td>
<td>2.4%</td>
<td>1.8%</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

Table 3 shows the cumulative returns for 3-year, 5-year, and 10-year periods. After experiencing a significant market rebound beginning in 2009, the annualized 10-year return is now 7.5% compared to the actuarial target of 7.0%.
### G. Pension Expense and Funded Percentage Projections

#### 1. Pension Expense Projections

A projection of estimated minimum required contributions for the period 2014 through 2023 is shown in Chart 6. The projections include any changes in participant levels based on the headcount assumptions for the period 2014 thru 2018. In addition to the minimum required contributions, the maximum tax deductible amounts are included. Under the PPA, maximum contributions are generally equal to the sum of 150% of the funding target, the target normal cost, an allowance for future pay or benefit increases, less the actuarial value of assets. The deductible limit will not be less than the minimum required contribution.

[Remainder of page intentionally left blank]
The projected minimum required contributions significantly decrease after 2022 when the PPA funding level is reached and any prior shortfall is expected to be fully amortized. The estimates are based on an assumed 7.0% investment return and a 6.48% effective interest rate in 2014 which gradually trends to 4.39% in 2023. Increases in either the effective interest rate or the actual investment returns would decrease the minimum funding requirement. Conversely, decreases in these variables would increase the funding requirement.

2. **Funded Percentage Projections**

As noted in Chart 7, the funded percentage declines after 2015 with the decline in the EIRs and then increases to a full funding level by 2023 following a period of increased contributions. The projections assume a 7.0% investment return and higher EIRs in the early years which trend lower over time. The EIR trend is primarily impacted by HATFA as previously discussed in Section D.3.
Although the Plan funded ratio is not expected to fall to levels that would raise concerns regarding benefit limitations (i.e., below 80%), SCG requests that the actual amount funded be determined based on the greater of the minimum required contribution or the contribution necessary to maintain at least an 85.0% funded percentage.

H. Regulatory Treatment

As discussed above, SCG is required to make minimum contributions to its pension trust in accordance with ERISA and the IRC. The amount of the required minimum contribution can fluctuate over time based on factors not subject to management control. The two-way balancing account allows SCG to recover required pension contributions based on prescribed actuarial calculations that consider external variables such as market return on invested assets, interest rates and federal legislative changes.

The Commission has consistently approved the use of a two-way balancing account as the mechanism for addressing the risk of variability in pension expense. In the SCG 2008 General Rate Case (“2008 GRC”), the Commission (in D.08-07-046) approved a settlement
agreement ("Settlement Agreement") that provided for annual pension funding based on the minimum required contribution.

At the time of the settlement, the 2009 SCG Plan contribution was projected to be $0. As a result of the large decline in Plan asset values due to the world-wide financial crisis, the projected timing and level of required contributions dramatically changed. A minimum contribution of $75.1 million was required in 2009, a year earlier than expected and at a much higher level.

In response to the material change in circumstances, SCG filed a petition to modify D.08-07-046 to permit an annual balancing account true-up rather than the previously approved mechanism. In D.09-09-011, the Commission approved SCG’s petition to modify the mechanism for recovery of pension expenses. The Settlement Agreement was “modified to allow the annual amortization of pension contributions recorded in the Pension Balancing Account incremental to the contributions included in the settlement revenue requirement.”

Pacific Gas and Electric Company ("PG&E") has a similar pension cost recovery mechanism. In D.06-06-014, the Commission adopted an uncontested PG&E settlement that established a two-way Pension Contribution Balancing Account ("PCBA") to track any variations from authorized contributions. The PCBA would reflect any contributions that were lower than the authorized amount and any higher contributions that were required under federal law.

Like SCG, PG&E also experienced a decline in its pension plan asset values. Subsequent to the SCG’s petition, PG&E requested a modification of its mechanism for recovery of pension expense (Application 09-03-003). PG&E proposed adjusting its pension contributions on an annual basis rather than waiting until the end of its three- to four-year general rate case cycle. PG&E stated that an annual true-up would permit a more timely response to financial market volatility and the impact on funded status.

In D.09-09-020, the Commission adopted the All-Party Settlement Agreement related to PG&E’s pension cost recovery mechanism between PG&E, the Coalition of California Utility Employees, and the Division of Ratepayer Advocates. Specifically, the decision ordered PG&E to (1) retain its PCBA; (2) implement an annual true-up of the PCBA; and (3) recalculate its pension contribution and revenue requirements if and when the actual funded status falls below 85%.
Pursuant to D.08.07-046, the disposition of the Pension Balancing Account (“PBA”) would occur at the end of the 2008 GRC cycle and be resolved in the next general rate case; however, pursuant to D.09-09-11, SCG was authorized annual amortization of the PBA balance. In SCG’s 2012 General Rate Case decision [D.13-05-010], the Commission approved the Company’s request to continue the two-way balancing account treatment and the annual amortization of the PBA based on the fact that the circumstances supporting such a mechanism had not changed which continues to be the case. The PBA is described in detail in the testimony of Regulatory Accounts Witness Reggie Austria (Ex. SCG-33), including the SCG proposal to continue the annual amortization of the PBA as adopted in D.09-09-11.

In conclusion, SCG proposes that the minimum required Plan contribution and revenue requirement would continue to be based on the greater of the ERISA minimum required annual contribution or such contribution as required to maintain a Plan funded status that is at least 85.0%. The Company’s proposal is consistent with prior Commission decisions, including D.13-05-010, and continues to protect the ratepayers from potential variability in funded status due to multiple external factors.

III. POST-RETIREMENT BENEFITS OTHER THAN PENSION (“PBOP”)

A. Summary Description

1. Participant Demographics

SCG provides post-retirement health and life insurance benefits, collectively referred to as PBOP or the PBOP Plan. Cost projections for the PBOP Plan consider the future cost of providing benefits to active employees. There are approximately 7,600 active employees (5,300 represented and 2,300 non-represented) with an average age of 45.4 years and an average of 16.3 years of service. There are approximately 5,000 retirees and survivors. Retirees who are currently receiving benefits average 73.4 years of age.

2. SCG Union Employees

Represented SCG employees are eligible for PBOP upon retirement after age 55 with 15 years of service or after age 65 with 5 years of service. Eligible retirees can elect medical coverage from a number of plans offered through Anthem Blue Cross, Kaiser or UnitedHealthcare. The Company also provides mental health, substance abuse, dental and life insurance benefits. Retiree life insurance coverage is equal to final base pay until the retiree reaches age 65. At age 65 and age 68 the coverage level drops to 50% and 25%, respectively, of
final base pay. Access to a discount vision program is provided; however, the retiree pays all

Retiree contributions for medical coverage vary depending on the date of retirement, age, and years of service. Retirees pay a portion of dental premiums; however, life insurance is solely paid by the Company.

Effective December 1, 2009, benefits include a health reimbursement account (“HRA”). Individual HRA accounts are established at the date of retirement and are available to reimburse retirees for qualified medical expenses during retirement. Opening account balances, which are determined at date of retirement, are based on the value of a percentage of unused sick leave and all unused vacation. HRA accounts receive monthly interest credits, on the unused balance, based on a 30-Year U.S. Treasury bond rate.

Effective March 1, 2012, represented employees who had 15 or more years of service as of July 1, 2012 were provided a one-time election to continue in the existing postretirement medical plan insurance premium cost-sharing structure or elect a defined dollar benefit (“DDB”) premium cost-sharing structure. Under the DDB cost sharing structure, the Company provides a fixed contribution toward the cost of medical coverage and the retired employee pays the difference. Relative cost depends on the selected health insurance plan and coverage level: retiree only or retiree with one or more dependents. Employees with less than 15 years of service as of July 1, 2012 will receive the DDB cost sharing structure at retirement.

3. SCG Non-represented Employees

SCG non-represented employees who retired prior to January 1, 2006 generally participate in the same pre-2012 PBOP provided to represented employees. Effective January 1, 2006, eligibility requirements were changed to retirement after age 55 with 10 years of service or age 62 with at least 5 years of service. The Company contributes a DDB amount for medical and dental benefits based on coverage level: retiree-only or retiree with one or more dependents. Mental health and substance coverage is also included. Access to a discount vision program is provided; however, the retiree pays all costs. Term retiree life insurance coverage of $25,000 is paid entirely by the Company. Non-represented employees are not eligible for the HRA benefit.

B. PBOP Cost Estimate

An annual certified actuarial valuation of the PBOP Plan is prepared by the Company’s actuary that includes the value of benefit obligations and minimum required contributions. The
valuations are performed in accordance with generally accepted actuarial principles and practices. PBOP expense includes both current retirees and an allocation of costs for current employees who are expected to access benefits in the future upon retirement. PBOP costs are determined pursuant to Financial Accounting Standard (“FAS”) 715-60. Table 4 provides a summary of the PBOP expense based on FAS 715-60.

Table 4 – SCG Summary of 2013 vs. 2016 PBOP Expense

<table>
<thead>
<tr>
<th>Cost Center</th>
<th>Benefit Description</th>
<th>In Thousands</th>
<th>2013 Actual</th>
<th>2016 Budget¹</th>
<th>2013-2016 Change</th>
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<tbody>
<tr>
<td>2200-8001.000</td>
<td>PBOP</td>
<td></td>
<td>$ 9,034</td>
<td>$ 1,520</td>
<td>$(7,514)</td>
</tr>
</tbody>
</table>

¹Reflects current projected PBOP contribution

Chart 8 illustrates the actual 2010 thru 2013 FAS 715-60 expense and projected amounts for the period 2014 through 2019. For the majority of the plan’s population, the maximum tax deductible contributions are based on the difference between the present value of projected benefits and the market value of PBOP assets. In 2013, the FAS 715-60 expense was approximately $9.0 million compared to a maximum tax deductible amount of $50.1 million.
Chart 9 provides a comparison of the projected PBOP expense in the 2012 GRC compared to the 2016 GRC. The decrease in PBOP expense from 2012 to 2016 is based primarily on the change in premium cost sharing structure for represented employees. The majority of employees, both represented and non-represented, now receive benefits under the DDB cost sharing structure which eliminates much of the volatility related to medical premium increases.

**Chart 9 – SCG PBOP Actual vs. Projected Expense: 2010 – 2023**

C. **Test Year PBOP Expense**

Similar to pension expense, PBOP expense is difficult to project with certainty due to the impacts of numerous variables including benefit utilization, healthcare escalation, PBOP Plan asset returns, interest rates and plan design. Consequently, the current estimated test year contribution of $1.67 million, the projected FAS 715-60 expense, is likely to change. Any 2016 variance between authorized and actual contributions would be subject to the current PBOP two-
way balancing account mechanism, as proposed in the Direct Testimony of witness Reggie Austria (Ex. SCG-33).

**D. Health Care Cost Escalation**

Medical benefit cost assumptions and trend rate have a significant impact on actual and projected plan expense. Historically, trend rates have exhibited a cyclical pattern. Chart 10 illustrates average medical cost increases for the period 1993 thru 2014, as reported by the Towers Watson Health Care Cost Survey. The comparison to the Consumer Price Index shows the significance of medical care cost increases and its relative value compared to other non-health related goods and services.

**Chart 10 – Average Medical Cost Increases: 1993 – 2014**

The projection of PBOP expense includes an actuarial projection of future health care escalation factors, both short-term and long-term. In the short term, trend rates reflect recent changes in annual increases due to health care cost increases and participant utilization levels. The ultimate trend is more indicative of general economic conditions.

The decrease in PBOP expense from 2012 to 2016 is based primarily on the change in premium cost sharing structure for represented employees. However, the medical trend continues to impact the cost of benefits primarily for retirees and grandfathered represented
employees where the cost sharing is not based on a DDB but rather a percentage cost sharing structure. As shown on Chart 11, the GRC 2016 pre-age 65 health trend assumptions for the period 2014 thru 2025 are slightly higher than those projected in the 2012 GRC.

Chart 11 – Medical Health Care Trend: 2012 GRC vs. 2016 GRC

The projected 8.3% aggregate increase for 2015 is based on preliminary renewal rates received from the Company’s health insurance providers. The Company and its consultant, Towers Watson, continue to review the basis for any increase in medical cost, including participant utilization and the impact of the Patient Protection and Affordable Care Act.

E. PBOP Assets and Liabilities

PBOP plans are prefunded using a number of funded and flow-through voluntary employee benefit association trusts (“VEBAs”) as well as a 401(h) trust. As with the pension trust, the funded VEBAs and 401(h) trust suffered significant declines in the market value of assets during the financial decline in 2008. Since then, the accumulated postretirement benefit obligation funded percentage continues to improve as shown in Chart 12. The 2009 funded
percentage was 64.6% which has now increased to 87.7% in 2013 with projected post-2014 levels at or above 100.0%.


Chart 13 compares the 2012 GRC PBOP Plan funded ratios to the latest 2016 GRC projection. The post-2013 funded ratios show the combined impact of the market recovery on Plan assets, discount rates and benefit premium cost sharing changes affecting the liability.

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F. Regulatory Treatment

The future costs related to PBOP are difficult to determine due to the numerous variables that affect the actual FAS 715-60 expense including the applicable discount rate, actual investment returns on plan assets, plan design features, demographic characteristics, health care inflation, claims experience, and legislative changes. In response to this forecasting challenge, the Commission has approved recovery of PBOP expenses subject to a two-way balancing account to adjust the revenue requirement to the FAS 715-60 costs actually incurred, limited by the maximum tax deductible amount allowed by the IRC. This approach has been employed for all California utilities for almost 24 years (see D.92-12-015).

The Commission has consistently approved the use of a two-way balancing account mechanism for addressing the risk of variability in PBOP expense. In the 2008 GRC, the Commission (in D.08-07-046) approved a settlement agreement (“Settlement Agreement”) that provided for annual PBOP funding in rates based on an estimate of FAS 715-60 expense. Any
increase or decrease in actual expense, limited by the amounts permitted as deductible by the
IRS, would be recorded as an adjustment to the Post-retirement Benefits Other than Pensions
Balancing Account (“PBOPBA”).

In conjunction with its request to modify the mechanism for recovery of pension expense,
SCG also requested permission to implement an annual PBOPBA true-up rather than wait until
the next scheduled general rate case. In D.09-09-011, the Commission approved SCG’s petition
to modify the mechanism for recovery of PBOP expenses as ordered in D.08-07-046 and “allow
the annual amortization of Post-Retirement Benefits Other than Pensions recorded in the …
[PBOPBA] incremental to the expenses included in the settlement revenue requirement.”

As with pension benefits, SCG received approval from the Commission in D.13-05-010
to continue the two-way balancing account treatment and the annual amortization of the
PBOPBA, since the circumstances supporting such a mechanism had not changed. The impact
of external factors in determining PBOP expense continues to effect the annual and projected
determination of this expense. The PBOPBA is described in detail in the testimony of
Regulatory Accounts Witness Reggie Austria (Ex. SCG-33), including the SCG proposal to
continue the annual amortization of the PBA as adopted in D.09-09-11.

This concludes my prepared direct testimony.
IV. QUALIFICATIONS – WITNESS DAVID SARKARIA

My name is David Sarkaria. My business address is 101 Ash Street, San Diego, California. My current position is Senior Director Compensation and Benefits for Sempra Energy. The Compensation and Benefits department supports the Sempra Energy Corporate Center and Sempra Energy’s other business units including San Diego Gas & Electric and the Southern California Gas Company.

My present responsibilities include managing Sempra Energy’s overall compensation and benefit programs, including all benefits-related compliance activities.

I hold a Bachelor in Chemistry from California State University, Long Beach; Master in Business Administration from California State Polytechnic University, Pomona; and Juris Doctorate from Western State University College of Law, Fullerton, California. I am a licensed member of the California State Bar, Certified Internal Auditor, Certified Fraud Examiner, Certified Employee Benefits Specialist, Certified Compensation Professional, and Senior Professional in Human Resources.

I joined the Southern California Gas Company in 1994, moved to Sempra Energy in 1998 and have held various positions within the Accounting, Finance, and Human Resources areas. Prior to being employed by Southern California Gas Company, I was engaged in private law practice and prior to that was a tax counsel with Phillips Petroleum in Houston, Texas.

I am sponsoring the Pension and Postretirement Benefits Other Than Pension testimony in Southern California Gas Company’s 2016 General Rate Case Application. I have previously testified before the California Public Utilities Commission.