BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

KEYSPAN GAS EAST CORPORATION d/b/a NATIONAL GRID and
THE BROOKLYN UNION GAS COMPANY d/b/a NATIONAL GRID NY

Cases 16-G-0058 and 16-G-0059

MAY 2016

Prepared Testimony of:

Staff Accounting Panel

RONALD F. CALKINS, Supervisor
Utility Accounting and Finance

SANIELLE WORRELL, Supervisor
Utility Accounting and Finance

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Public Utilities Auditor 2

MARGARET E. WRIGHT
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Q. Staff Accounting Panel, would you please state your names and business addresses?
A. We are Ronald F. Calkins, Sanielle Worrell, Luke J. Quackenbush, Margaret E. Wright, and John P. Castano. Our business address is Three Empire State Plaza, Albany, New York 12223.
Q. Mr. Calkins, by whom are you employed and in what capacity?
A. I am employed by the Department of Public Service as a Supervisor, in the Office of Accounting, Audits and Finance.
Q. Mr. Calkins, please summarize your education and work experience?
A. I graduated from Siena College with a B.B.A. in Accounting. In June of 1969, I joined the Department of Public Service.
Q. Mr. Calkins, have you previously testified before the Commission?
A. Yes. I have testified in various electric, gas and telephone rate proceedings.
Q. Ms. Worrell, what is your position at the department?
A. I am employed by the Department of Public Service as a Supervisor in the Office of

Accounting, Audits and Finance.

Q. What is your educational and business experience?

A. I graduated from St. Francis College, in Brooklyn, NY in 2004 with a Bachelor’s degree in Business Management. I received a Master’s degree in Accounting in 2006 from St. John’s University in Queens, NY. In 2009, I became a Certified Public Accountant in the State of New York. From January 2007 through May 2010, I worked as an external auditor for Ernst & Young, LLP in New York, NY. In this position, I performed and supervised financial statement audits and advisory engagement for a number of companies in the Financial Services industry. I have held additional supervisory positions in the Finance Communication and Government industry, functioning in internal audit and financial reporting roles. I joined the Department of Public Service in June 2015.

Q. Please describe your responsibilities with the Department.

A. My responsibilities include the examination of accounts, records, documentation, policies and procedures of regulated utilities.

Q. Ms. Worrell, have you previously testified before the Commission?

A. No. I have not testified before the Commission.

Q. Mr. Quackenbush, by whom are you employed and in what capacity?

A. I am employed by the Department of Public Service as a Public Utilities Auditor II in the Office of Accounting, Audits and Finance.

Q. Mr. Quackenbush, please summarize your education and work experience?

A. I graduated from the State University of New York College at Cortland with a B.A. in Sport Management, with minors in Business and Economics in 2006. Thereafter, I graduated from The College of Saint Rose in Albany, New York, with a M.S. in Accounting in 2010. I worked for two and one-half years as a Staff Accountant at the public accounting firm Brown & Fitzgerald, P.C. in Latham, New York. During that time, I assisted in performing audits, reviews, and compilations, as well as tax review and preparation. In December 2012, I joined the Office of Accounting, Audits and Finance within the Department as a Senior Auditor.

Q. Mr. Quackenbush, please describe your responsibilities with the Department.

A. My responsibilities include the examination of accounts, records, documentation, policies and procedures of regulated utilities.

Q. Mr. Quackenbush, have you previously testified before the Commission?

A. Yes. I have testified before the Commission in Case 15-G-0382, St. Lawrence Gas Company.

Q. Ms. Wright, what is your position at the Department?

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

Q. Please describe your educational background and professional experience.

A. I received a Master’s degree in Business Administration in 2011 from Columbia College. I also received a Bachelor’s degree in Business Administration, with a concentration in accounting from Columbia College in 2004. In June 2014, I joined the Department of Public Service in the Office of Accounting, Audits & Finance. Prior to that I was employed by the

New York State Office of the Medicaid Inspector General as a Senior Auditor for four years.

Q. Please describe your responsibilities with the Department.

A. My responsibilities include the examination of accounts, records, documentation, policies and procedures of regulated utilities.

Q. Ms. Wright, have you previously testified before the Commission?

A. Yes. I testified before the Commission in the Town of Massena Electric Department rate proceeding, Case 15-E-0307.

Q. Mr. Castano, what is your position at the Department?

A. I am employed by the New York State Department of Public Service in the Office of Accounting, Audits and Finance as an Auditor Trainee 2.

Q. Please describe your educational background and professional experience.

A. I graduated from the State University of New York Institute of Technology in 2013 and have Bachelor of Science degrees in Accounting and Business. I have been employed by the Department since September 2014.

Q. Please describe your responsibilities with the Department.

A. My responsibilities include the examination of accounts, records, documentation, policies and procedures of regulated utilities.

Q. Mr. Castano, have you previously testified before the Commission?

A. Yes. I have testified before the Commission in Cases 15-E-0283, 15-G-0284, 15-E-0285, and 15-G-0286, New York State Electric and Gas and Rochester Gas and Electric rate proceedings. I have also been involved in other municipal electric rate proceedings.

Q. Panel, what is the purpose of your testimony?

A. We will address various issues of the rate filing by KeySpan Gas East Corporation d/b/a National Grid (KEDLI), and The Brooklyn Union Gas Company d/b/a National Grid NY (KEDNY)(collectively, the Companies), specifically: operating revenues; merchant function charge; PricewaterhouseCoopers Analysis; National Grid Management Audit Case 13-G-0009;_contractors; other expense; National Grid Service Company (Service Company) rent expense; pension/OPEBs; labor expense; transportation; productivity; other initiatives; regulatory assessment fees; joint facilities; carrying charges; and payroll tax.

Q. Please summarize KEDLI's requested gas revenue requirement.

A. In its January 29, 2016, initial filing, KEDLI requested a $141.8 million total bill increase. In its April 4, 2016 Corrections and Updates filing, KEDLI decreased the total bill increase to $141.1 million which includes a base rate increase of $174.7 million as stated on page 3 of the Company Revenue Requirements Panel's testimony.

Q. Would you please summarize Staff's recommendation regarding KEDLI's requested gas revenue requirement?

A. We recommend a gas base rate increase of $116.1 million, or approximately $58.6 million less in revenues than the amount requested by the Company. Exhibit__(SAP-1), Schedule 6, lists every adjustment Staff witnesses and panels recommend that makes up this 58.6 million revenue requirement differential with the

exception of Staff’s return on equity.
Q. Please summarize KEDNY’s requested gas revenue requirement.
A. In its January 29, 2016, initial filing, KEDNY requested a $245.0 million total bill increase. In its April 4, 2016 Corrections and Updates filing, KEDNY decreased the total bill increase to $244.7 million which includes a base rate increase of $290.0 million as stated on page 3 of the Company Corrections and Updates Revenue Requirements Panel’s testimony.
Q. Would you please summarize Staff’s recommendation regarding KEDNY’s requested gas revenue requirement?
A. We recommend a gas base rate increase of $263.0 million, or approximately $27.0 million less in revenues than the amount requested by the Company. Exhibit__(SAP-2), Schedule 6, lists every adjustment Staff witnesses and panels recommend that make up this $27.0 million revenue requirement differential with the exception of Staff’s return on equity.
Q. Is this Panel sponsoring any Exhibits?
A. Yes, we are sponsoring 3 Exhibits;

Exhibit__(SAP-1), Exhibit__(SAP-2), Exhibit__(SAP-3), and Exhibit__(SAP-4).

Q. Would you describe Exhibit __ (SAP-1)?

A. Exhibit__(SAP-1) is our rate year cost of service presentation for KEDLI, consisting of 11 schedules. Schedule 1 summarizes our projection of gas operating income, rate base and rate of return for the rate year ending December 31, 2017, and includes our proposed base rate decrease. Schedule 1 is supported by Schedules 2 through 11. Schedule 2 is a summary of operating expenses. Schedule 3 is the computation of state and federal income tax. Schedule 4 is summary of rate base. Schedule 5 is a summary of the capital matrix. Schedule 6 is a listing of Staff’s adjustments. Schedule 7 is a calculation of taxes other than income tax. Schedule 8 is a summary of depreciation and amortization expense. Schedule 9 is the calculation of the interest expense. Schedule 10 is the calculation of supplemental cash working capital. Schedule 11 is the summary of the historic earnings base vs. capitalization at September 31, 2015.

Q. Would you briefly describe Exhibit __(SAP-2)?

A. Exhibit__(SAP-2) is our rate year cost of service presentation for KEDNY, consisting of 11 schedules. Schedule 1 summarizes our projection of gas operating income, rate base and rate of return for the rate year ending December 31, 2017, and includes our proposed base rate increase. Schedule 1 is supported by Schedules 2 through 11.

Q. Would you describe Exhibit __ (SAP-3)?

A. Exhibit __ (SAP-3) includes the Information Request (IR) responses that we rely upon throughout our testimony. We will refer to these IRs by the number assigned by Staff, e.g., DPS-50.

Q. Would you describe Exhibit __ (SAP-4)?

A. Exhibit __ (SAP-4) is a detailed report and analysis provided to Staff by the Companies on Recommendation IX-6, concerning the allocation of costs from the Energy Procurement group to NY gas Companies. This recommendation was part of a comprehensive management and operations audit performed on National Grid USA’s New York gas companies in Case 13-G-0009.

Operating Revenues

Q. Does the Panel recommend any adjustments to rate year operating revenues?

A. Yes. We recommend a correcting upward adjustment of $606,000 for KEDLI, and a correcting upward adjustment of $90,000 for KEDNY.

Q. Please explain the adjustments you propose.

A. In the corrections and updates filed by the Companies on April 4, 2016, Exhibit __ (RRP-1CU) and Exhibit __ (RDP-2CU) were not in agreement on the total operating revenues being projected. KEDLI and KEDNY show operating revenues of $900.782 million and $1,351.169 million, respectively, on Exhibit __ (RDP-2CU), Schedule 1, page 1. On Exhibit __ (RRP-1CU), Summary, page 1, KEDLI and KEDNY show operating revenues of $900.176 million and $1,351.079 million, respectively. In response to DPS-413, the Companies stated that the correct operating revenue amounts were filed on Exhibit __ (RDP-2CU), summary, page 1, not the Exhibit __ (RRP-1CU). We made the aforementioned adjustments to correct this error.

Merchant Function Charge

Q. What are the Companies projected rate year Merchant Function Charge (MFC) Revenues?

A. KEDLI and KEDNY show MFC revenues of $30.256 million, and $12.535 million, respectively, on Exhibit __ (RDP-2CU), Schedule 1, page 1. Referring to the Companies’ response to IR DPS-414, Exhibit __ (RDP-2CU) shows a total projected MFC revenues at current rates.

Q. What are the forecasted MFC expenses?

A. KEDLI and KEDNY show MFC expenses of $18.734 million, and $10.583 million, respectively, on Exhibit __ (RDP-6CU), Schedule 1, page 1. Referring to the Companies response to IR DPS-414, Exhibit __ (RDP-6CU) shows total projected MFC revenues at proposed rates. The proposed MFC amounts shown in RDP-6CU, Schedule 1 are based on the results of updated competitive function studies, updated uncollectible rates, updated lead lag studies and the Companies’ proposed pre-tax WACC.

Q. Are the MFC Revenues overstated?

A. Yes. The MFC requires a revenue to match the associated expense.

Q. Does the Panel propose any adjustments to the MFC revenues?

A. Yes. We propose to decrease the MFC revenues, to match the MFC expenses that are being reflected at the Companies' proposed rates. This adjustment decreases MFC revenues by $11.522 million and $1.952 million for KEDNY and KEDLI, respectively.

Joint Facilities

Q. Describe how the Companies developed their rate year joint facilities forecast.

A. The Companies began with its historical test Year actual joint facilities expenses for the period from October 2014 through September 2015. These figures represent each Companies' share of carrying costs and O&M costs associated with shared facilities, or the New York Facilities System (NYFS), and updated this amount based on an inflation rate. The Companies also presented historical revenues received. The Companies proposed to recover these costs outside of base rates through respective NYFS surcharge and removed these costs from their income statement by netting expenses against revenues for purposes of determining the revenue requirements.

Q. Do you recommend adjusting the Companies' joint facilities forecast?

A. Yes. The Companies have noted that the agreement that governs the Joint Facilities cost is currently being renegotiated. The numbers currently presented in these proceedings could be adjusted based on renegotiations. We recommend that, based on the uncertainty of when a final agreement will be negotiated with updated costs, the Companies should continue to recover cost through base rates. The Companies should be required to file a formal petition to the Commission seeking alternative ratemaking treatment for the revenues received and costs incurred when the updated agreement is finalized. To reflect this recommendation, we adjusted the Companies' revenues to include updated revenue amounts based on historical joint facilities revenues of $9.230 million and $4.092 million for KEDLI and KEDNY, respectively. We added an escalation for inflation at a rate of 3.7732%, or $348,252 and $154,415 for KEDLI and KEDNY, respectively. This results in a rate year forecast of $9.558 million and $4.247 million for KEDLI and KEDNY, respectively. Therefore we have reflected, an upward adjustment to operating revenues for KEDLI in the amount of $4.299 million and a downward adjustment to operating revenues for KEDNY in the amount of $6.493 million.

Operation & Maintenance Expenses

PricewaterhouseCoopers Analysis

Q. Please explain the Companies' review of the historic test year costs.

A. As explained in pages 12 through 23 of the Revenue Requirement Panel testimonies, the Companies hired PricewaterhouseCoopers LLP, PwC, to conduct an independent review of the accounting for costs in the historic test year including (i) costs directly charged to KEDLI and/or KEDNY, or allocated to them from the Service Company and (ii) costs either originating in KEDLI and/or KEDNY or charged to them by their affiliates. PwC reviewed operation and maintenance (O&M) charges for (1) vendor costs, (2) labor costs, (3) employee expense costs, and (4) operating expense general ledger journal entries to determine that (1) the charge was recorded to or allocated to the appropriate Company or Companies, (2) if allocated, an appropriate allocation code was used, and (3) the work for which the charge was incurred took place.

Q. Please summarize PwC's analysis and findings.

A. PwC based its analysis on sampling a majority of the population of charges for vendor costs, labor cost and employee expenses. For instance for KEDNY vendor costs, PwC sampled $248 million of transactions totaling $429 million; for employee expenses, PwC sampled $0.510 million out of a population of $1.182 million; for labor expense PwC sampled $111.5 million out of $119.2 million; for transactions and for journal entries, PwC reviewed $406.1 million out of $549.1 million. From this sampling, PwC determined the historic test year costs incurred were charged appropriately.

Q. Did the Companies make any adjustments to their historic test year charges based on PwC’s analysis?

A. No. PwC’s analysis and review resulted in a net exception that was very small in the context of this case, with one of the exceptions related to Site Investigation and Remediation (SIR) costs incurred outside of the historic test year.

Q. Do you agree with the findings of the PwC review of the historic test year O&M costs?

A. Yes. We undertook a detailed review of the PwC analysis, and found the PwC findings to be reasonable. We do not propose any adjustments to the PwC results.

National Grid Management Audit Case 13-G-0009

Q. Describe Recommendation IV-1 concerning the US Foundation Project (USFP), USFP Stabilization and Finance Remediation, included in the final audit report issued on October 2, 2014 in Case 13-G-0009, the Management Audit of National Grid USA’s New York gas companies.

A. This recommendation instructed the Companies to provide appropriate documentation associated with USFP, USFP Stabilization, Finance

Remediation and other initiatives and provide assurance that the incremental costs associated with these efforts are being absorbed by shareholders.

Q. Did the Companies provide a report detailing this information?

A. Yes. In compliance with the implementation plan, the Companies submitted a report to Staff on April 1, 2015. The Companies Shared Services Panel have addressed the costs of the USFP and Finance Remediation at pages 78 to 84 of its direct testimony and also included relevant excerpts from the filed report in Exhibit __ (SSP-13).

Q. Did you review the report submitted by the Companies?

A. Yes. We reviewed and verified the Companies' process to ensure that shareholders bore all stabilization costs. Invoices were randomly selected from their report to verify they were capital costs relating to USFP. Invoices that contained both capital and stabilization costs were further reviewed to verify capital costs were charged to the Service Company and the stabilization costs were charged to the parent company, National Grid USA. A high level review of the financial remediation costs was also performed to verify incremental costs were being also charged to National Grid USA.

Q. After your review, do you believe that the Companies' report properly documents the total capital costs for USFP?

A. Yes, at the time the report was submitted.

Q. Does the total USFP capital costs shown in the rate case match the amount shown in this report?

A. No. The capital amounts shown in the rate case include an update of estimates and includes an amount that was inadvertently excluded in the USFP report.

Q. Do you agree with the capital costs for USFP provided in the Companies' filings in these proceedings?

A. Yes. We believe that the costs for the USFP project provided in the rate case is correct and excludes all stabilization costs.

Q. Describe Recommendation IX-6 concerning the allocation of costs from the Energy Procurement group to the NY Gas Companies.

A. This recommendation instructed the Companies to conduct a thorough investigation of the allocation and assignment of costs from the energy procurement group to the NY gas utilities to identify the reasons for the NY gas utilities receiving an apparent disproportionate share of costs.

Q. Did the Companies complete this review?

A. Yes. The Companies performed a detailed analysis and submitted a report to Staff on June 24, 2015. The submitted report is provided in Exhibit __ (SAP-4).

Q. Have you reviewed this report?

A. Yes.

Q. Why did it appear that the New York Gas Companies were receiving a disproportionate share of the costs?

A. First, seventy percent of National Grid USA’s gas customers are in New York, and since gas supply procurement requires more labor support than electricity procurement, it is practical that New York would receive a larger share of the energy procurement group’s costs. Second, two functional areas are now being included in the energy procurement’s reported costs. This and the shifting of the cost causative allocation methodology for non-gas costs both attributed to increase allocated costs to National Grid USA’s New York gas companies.

Q. After your review of the Companies’ filed report, do you believe ratepayers have been charged fairly and costs have been properly allocated?

A. Yes. We have sampled invoices and verified they were correctly allocated, using the correct allocation percentages in effect at the time. Additionally, we looked at the National Grid USA energy procurement expenses by department to verify that two function groups were now being included in the energy procurement cost center, but were not in previous years. Also, we confirmed that there was a change in the allocation methodology, which increased the allocated costs to National Grid USA’s New York gas companies.

Contractors

Q. Does the Panel have any adjustments to the O&M cost element of contractors expense?

A. Yes, we recommend a downward adjustment be made to the rate year projection of contractor O&M expense for KEDNY of $578,013.

Q. What information did the Panel rely upon to derive this recommended adjustment?

A. We used the information provided by KEDNY in response to IRs DPS-287 and DPS-422.

Q. How does KEDNY calculate the rate year contractors expense?

A. Similar to its projection of some of the other O&M cost elements, KEDNY derives the rate year forecast beginning with the historic test year actual, then removes charges considered non-recurring through the test year analysis review. KEDNY then applies an inflation factor of 4.2964% to determine the rate year forecast. On April 4, 2016 in the Companies' Corrections and Updates filing, the inflation factor was updated to 3.7732%. Utilizing the updated inflation factor, the projected rate year amount for total contractor's expense for KEDNY is

$61.343 million.

Q. Does the Panel agree with the methodology used for KEDNY'S contractor expense rate year forecast?

A. Yes. We agree with the methodology that was used to calculate the contractor expense for KEDNY, with one exception. There is a charge incurred in the historic test year that should be normalized out, before inflation is applied, to develop the rate year allowance.

Q. Please explain your adjustment.

A. KEDNY incurred several charges for the vendor ULC Robotics, Inc. The total charges assessed to KEDNY in the historic year was $556,997. In the Company's response to IR DPS-287, KEDNY provided copies of the invoices for this vendor. A review of the invoices indicates these charges were for Cast Iron Sealing Robot (CISBOT) activity. We recommend that these charges be normalized out from the historic test year.

Q. Why does the Panel believe these charges should be removed?

A. As stated in KEDNY's Response to IR DPS-422, the costs for CISBOT activities are classified as capital expenditures. The ULC Robotics invoice costs were classified into capital expenditures after the historic test year and should have been normalized out. Therefore, these expense charges should be removed from the historic test year base that KEDNY uses to project the rate year.

Q. What effect does removing these charges have on KEDNY'S projected rate year for Contractors expenses?

A. Based on the review of the applicable nine invoices, KEDNY incurred historic year expenses of $556,997. Our adjustment is for the $556,997 plus inflation of $21,016, based on the updated inflation factor, for a total reduction to rate year contractors expense of $578,013.

<u>Other Expense</u>

Q. Does the Panel propose any adjustments to the O&M cost element of "other" expense?

A. Yes. We recommend a downward adjustment to the rate year projection of other expense for KEDNY of $1.098 million.

Q. What information did you rely upon to derive the recommended adjustment?

A. We used the information provided by KEDNY in response to IR DPS-266.

Q. What did KEDNY state in its response to IR DPS-266?

A. KEDNY defined the costs that get charged to the cost element other expense as expenses that do not get accounted for elsewhere. Similar to its projection of some of the other O&M cost elements, KEDNY derived the rate year forecast beginning with the historic test year actual, then removed charges considered non-recurring through the test year analysis review. KEDNY then applied an inflation factor of 4.2964% to determine the rate year forecast. On April 4, 2016 in the Company’s Corrections and Updates filing, the inflation factor was updated to 3.7732%. Utilizing the updated inflation factor, KEDNY projected the rate year amount for other expense at $18.621 million.

Q. Does the Panel agree with the methodology used for KEDNY’s other expense rate year forecast?

A. Yes. We agree with the methodology that was used to calculate the other expense for KEDNY, with one exception. There is a charge incurred in the historic test year that should be normalized out, before inflation is applied, to develop the rate year allowance.

Q. Please explain this adjustment.

A. KEDNY incurred several charges for the vendor New York City Finance Commissioner for violations assessed by New York City. The total charges assessed to KEDNY in the historic year were $4.409 million, of which $1.058 million was allocated to O&M expenses. The remaining $3.351 million was allocated to capital accounts. In the response to IR DPS-266, KEDNY provided copies of the invoices for this vendor. A review of the invoices indicates these charges for violations and fines were incurred for work being done by KEDNY in New York City. We recommend that these violations and fines be removed and normalized out of the historic test year.

Q. Why does the Panel believe these charges should be removed?

A. A review of these invoices shows the nature of these charges were well within KEDNY’s control and KEDNY should be taking steps to minimize these charges. In its response to IR DPS-266, KEDNY provided the historic costs for other expense for fiscal year end March, 31, 2013, 2014, and 2015. After review of these historic charges, we found that KEDNY has incurred charges related to the New York City Finance Commissioner in 2014 of $888,000, and in 2015 of $1.085 million. We do not believe that ratepayers should be paying for costs such as this when KEDNY had, and continues to have, the ability to modify its actions and not incur these penalty charges. KEDNY could have prevented these violations and fines had they followed applicable procedures/regulations. These expense charges should be removed from the historic test year base that KEDNY uses to project the rate year. However, we will reconsider our recommendation if the Company can demonstrate in rebuttal that specific charges were outside of its control, and what steps the Company are taking to minimize these fines in the future.

Q. What effect does removing these charges have on

KEDNY'S projected rate year for other expenses?

A. Based on the review of the applicable 51 invoices, KEDNY incurred historic year charges allocated to expense of $1.058 million for violations and fines. Our adjustment is for the $1.058 million plus inflation of $39,726, based on KEDNY's updated inflation factor, for a total reduction to rate year other expense of $1.098 million.

Q. Do you recommend any other adjustments related to the historic year charges incurred by the Company for the New York City fines and violations?

A. Yes, KEDNY stated in response to IR DPS-266 that $3.309 million was charged to capital accounts in the historic test year. In response to a follow up IR, DPS-485, the Company indicates that the $3.309 million of capital charges were added to plant in service in rate base. We recommend adjustments also be made to remove the amounts related to the identified fines and violations that are included in KEDNY's rate year rate base and associated depreciation expense.

Q. Can you identify the adjustments that need to be made?

A. Yes, based on the response to IR DPS-485, we recommend three additional adjustments be made. First, a downward adjustment of $3.252 million to net plant. Second, an upward adjustment of $865,122 to accumulated deferred income taxes. Third, a downward adjustment to depreciation expense of $63,423.

<u>Service Company Rent</u>

Q. Please explain what is included in the cost element of Service Company rent expense.

A. The Service Company owns a number of shared assets that are used either by Service Company employees to provide services to affiliates, such as KEDNY and KEDLI, or are used by the affiliates on a shared basis. These assets include shared office facilities and information software and systems. When the Service Company owns the shared assets, it charges the affiliates, an asset recovery charge which is based on a pre-tax return on the undepreciated asset value (net of deferred taxes,) and the annual depreciation expense.

Q. What do the Companies project for rate year Service Company rent expense?

A. Based on the Companies’ Correction and Updates filing, KEDNY projects rate year service company rent expense to be $15.225 million comprised of rate year rent return of $4.684 million and rate year depreciation of $10.540 million. Similarly, KEDLI projects rate year service company rent expense to be $15.264 million comprised of rate year rent return of $7.346 million and rate year depreciation of $7.918 million.

Q. Are you making any adjustments to Service Company Rent?

A. Yes, we recommend three normalizing adjustments to the rate year projection.

Q. Please explain the first adjustment.

A. As discussed in the Gas Policy and Supply Panel Testimony, Staff recommends removing the Customer Choice ESCO Gas project, which is a part of the Gas Transportation Information System.

Q. Please quantify the impact of this adjustment.

A. Referring to Exhibit RRP-3CU Schedule 9 Workpaper 2 the removal of Customer Choice ESCO gas Line 10 Project 3564 will reduce the rate year Rent Return and the rate rear Rent Depreciation. For KEDNY this will result in a reduction of rent return of $475,384 and rent depreciation of $940,497 for a total downward adjustment of $1.416 million. For KEDLI this will result in a reduction of rent return of $219,927 and rent depreciation of $435,102 for a total downward adjustment of $655,029.

Q. Please explain the second adjustment.

A. We recommend a downward adjustment to reflect bonus depreciation. In the rate year projections, the Companies failed to account for the impacts of the recently enacted extension of bonus depreciation.

Q. Please explain what bonus depreciation is.

A. Bonus depreciation is an additional amount of deductible depreciation that is awarded above and beyond what would normally be available. Pursuant to legislation recently passed in December 2015, Congress extended bonus depreciation through 2019.

Q. Why did the Companies not include the impacts of bonus depreciation in the rate year projection of service company rent expense?

A. In response to IR DPS-395, the Companies stated that they did not factor bonus depreciation in the amounts for the rent return portion of the Service Company rent expense because Congress had not passed legislation extending bonus depreciation until late December after the revenue requirement models were finalized.

Q. Do the Companies agree an adjustment should be made to the rate year projection of service company rent expense?

A. Yes, based on the Companies' response to IR DPS-395, the adjustment required to rate year service company rent expense is a downward adjustment of $699,300 for KEDNY and a downward adjustment of $508,915 for KEDLI.

Q. Does the Panel agree with the Companies' calculations of the impact of bonus depreciation?

A. No. We recommend removing the Customer Choice ESCO Gas project, and that adjustment impacts the calculation of bonus depreciation. The correct adjustment to rate year Service Company rent expense is a downward adjustment of $611,529 for KEDNY and a downward adjustment of $468,311 for KEDLI.

Q. Explain the third adjustment.

A. We recommend a downward adjustment to update the Service Company return on assets rate.

Q. What rate of return did the Company utilize for the service company asset recovery charge?

A. The requested service company return on assets is 9.95%, with the calculation shown on Exhibit (RRP-11), Workpapers to Exhibit_ (RRP-3), Schedule 9, Workpaper 8.

Q. Do you agree with the Company's calculated service company return on assets rate of 9.95%?

A. No, not entirely. We have substituted Staff's proposed capital structure and cost rates, provided by Staff witnesses Abdul Qadir and Patrick Piscitelli into the Company formula. This produces a return on assets rate of 9.38% for KEDLI and a return on assets rate of 8.81% for KEDNY. In developing rate year cost projections, we recommend these revised rate be used in place of the Companies' 9.95% rate.

Q. What is your proposed adjustment?

A. We applied our calculated return on asset rate of 9.38% for KEDLI and 8.81% for KEDNY to our adjusted service company base amount to calculate the rental fee amount the Companies' should be allowed to recover. We recommend an adjustment reducing rate year service company rent expense by $185,957 for KEDLI and $552,482 for KEDNY.

Pension and Other Post-Employment Benefits (OPEBs)

Q. How are the pension and OPEBs expenses currently reflected in rates for KEDNY and KEDLI?

A. Currently KEDNY's rate allowance for pension and OPEB expense is $19.2 million and $15.3 million, respectively. Similarly, KEDLI's rate allowance for pension and OPEBs expense is $13.9 million and $11.3 million, respectively. Currently, both KEDNY and KEDLI are subject to the Pension and OPEBs Policy Statement that allows for reconciliation of the rate allowance with the actual pension and OPEBs expense on its books with over or under recoveries being deferred.

Q. Have KEDNY and KEDLI forecast pension and OPEB expenses for the rate year?

A. Yes. KEDNY projected rate year pension and OPEBs expense of $38.7 million and $14.1 million, respectively. Similarly, KEDLI projected rate year pension and OPEBs expense of $18.0 million and $10.0 million, respectively. The Companies' forecasted rate year pension and OPEBs expenses are reasonable based on our review of the projections provided by Companies' actuary, and related actuary reports. The projections are contained in the Companies' Exhibit __ (RRP-3) Schedule 11 for OPEBs and Schedule 16 for pension, and supported by additional information included in Exhibit __ (RRP-11) Workpapers to Exhibit RRP-3 for Schedules 11 and 16.

Q. Have KEDNY and KEDLI made proposals with respect to the accounting for the funding of their respective pension and OPEBs expenses?

A. Yes. During the time period that both Companies were subject to the Pension and OPEBs Policy Statement, an analysis shows that their respective pension trusts were overfunded, but their respective OPEBs trusts were underfunded. KEDNY and KEDLI request that for purposes of determining its internal reserve and the associated carrying costs, that they be allowed to combine the funding of the pensions and OPEBs. This accounting treatment would require KEDNY and KEDLI to accrue and defer carrying charges on the net unfunded pension and OPEBs amounts, until the net unfunded amount is funded.

Q. Do you agree with this proposal?

A. Yes. The Commission has previously authorized the Niagara Mohawk Power Corporation, an affiliate of KEDNY and KEDLI, to net pension and OPEBs funding when calculating carrying charges. The forecasted effect of such treatment on KEDNY would be to reduce the combined pension/OPEB carrying charge liability from $19.0 million to $9.8 million. Similarly, the forecasted impact on KEDLI would be to reduce the combined Pension/OPEB carrying charge liability from $76.8 million to $47.6 million.

Q. Have KEDNY and KEDLI sought approval to record regulatory assets of approximately $1 million and $47 million, respectively, due to the expiration of the Management Services Agreement (MSA) with the Long Island Power Authority (LIPA)?

A. Yes.

Q. Please explain.

A. Under the MSA, certain KeySpan Electric Services, Inc. and Service Company employees provided services to LIPA. When the MSA expired and the provision of these services were assumed by PSEG-Long Island.

Q. Were there certain KeySpan Electric Services Inc., and Service Company employees who formerly provided services to LIPA and who were transferred to PSEG-Long Island?

A. Yes. As a result of these transfers, both KEDNY and KEDLI have requested to recognize pension and OPEB curtailment and/or settlement gains/losses in the associated plans for both its management and union workforces under accounting rules. The reduction in the obligation realized by KEDNY and KEDLI as a result of the MSA expiration results in the elimination of pension/OPEB plan net losses.

The recording of these regulatory assets would prevent KEDNY and KEDLI from absorbing otherwise recoverable pension and OPEB losses and would be amortized over a 10-year period.

Q. Do you agree with the recording of these regulatory assets?

A. At this time, no. Due to the complexity of this transaction, we are still auditing and reviewing the proposed pension and OPEB deferral and cannot yet reach a judgment as to whether the proposed treatment is appropriate.

Labor Expense

Q. Does Staff recommend any adjustments to rate year labor expense?

A. Yes. Staff witness Gadomski recommends one adjustment, which totals a recommended downward adjustment of $93,000 for KEDNY, and $60,000 for KEDLI.

Q. Does this adjustment have an effect on other line items?

A. Yes, flow through adjustments are made to payroll taxes and productivity.

Q. Do the Companies' labor expense forecasts include incremental employees?

A. No. The labor expense forecasts only reflect existing employees. The Companies have included the incremental employees in their discussion of “other initiatives,” which we will address later in our testimony.

Transportation Lease Expense

Q. Please explain how the Companies derived their rate year transportation lease forecast.

A. They began with their respective vehicle counts as of September 30, 2015, then forecasted the lease expense for existing leases through the term of the leases. Second, the Companies added the forecast of lease expense associated with replacement vehicles scheduled to be acquired prior to or in the rate year. The Companies then reduced this amount by estimated gains from vehicles sold at auction during the rate year. For KEDNY, this resulted in a $2.296 million increase, or 34%, for a rate year leasing cost forecast of $9.033 million. Of this amount, $4.890 million was allocated to operating expense, and $4.143 million allocated to capital. For KEDLI, these adjustments resulted in a $3.253 million increase, or 78%, for a rate year leasing cost forecast of $7.4 million. Of this amount, $2.540 million was allocated to operating expense, and $4.86 million allocated to capital.

Q. Did the Companies make any updates to their rate year transportation lease forecast?

A. Yes. The Companies’ response to IR DPS-236, Attachment 4, demonstrated that certain vehicle replacement leases were overlapping in the forecast data, causing a double count of certain lease expenses. The Companies accounted for this adjustment in their Corrections and Updates filing, provided on April 4th, 2016. These updates reduced the transportation lease forecast by $56,000, and $119,000, for KEDNY and KEDLI, respectively, and resulted in a reduction to KEDNY, and KEDLI operating expense by $30,400, and $40,700, respectively.

Q. Did the Companies use the historic test year to forecast their rate year lease costs?

Q. No. Referring to response to DPS-429 the Companies used forecast data to develop their rate year lease costs. The forecast lease data is developed by first querying the SAP Enterprise Central Components (ECC) to capture certain data for current active vehicles and replacement vehicles that are either on order or approved to be ordered. The ECC Data, along with manually developed forecast data for replacement vehicles that have yet to be approved for order, is used to build the monthly forecast of lease expense by vehicle. Other sources of data and inputs were used for other lease costs components that could not obtained from SAP ECC.

Q. Does the data used for the rate year forecast reconcile to the historic test year?

A. No.

Q. Do you agree with the Companies rate year projection?

A. No.

Q. What is your adjustment for rate year transportation lease expense?

A. Our adjustment reduces rate year lease transportation operating expense by $732,000, and $939,000, for KEDNY and KEDLI, respectively.

Q. How did you calculate this adjustment?

Q. The Companies' response to IR DPS-308, Attachment 2, show that 66 incremental vehicles are being added for KEDNY, and 26 incremental vehicles are being added for KEDLI. These incremental vehicles are forecasted to be added during the link period. The Companies are not forecasting any incremental vehicles to be added during the rate year. The forecasted lease expense associated with the incremental vehicles added during the link period is $608,000 and $231,000, for KEDNY and KEDLI, respectively. To calculate our adjustment, we began with the Companies historic test year lease costs, plus inflation. We then added the forecasted lease costs for incremental vehicles, plus inflation to arrive at our rate year forecast.

Q. Why did you use the historic test year data to project rate year costs?

A. Considering the issues previously noted, the Companies' rate year forecasting methodology is unreliable. Utilizing the historic test year serves as an appropriate starting point for a rate year forecast. By simply adding the forecasted lease expense associated with the incremental vehicles to the historic test year, allows for a simpler, more direct calculation.

Productivity

Q. Did the Companies include any productivity adjustment in their filings?

A. Yes. The Companies applied a productivity adjustment of a cumulative annual 1% of labor costs and payroll taxes.

Q. What is the Commission’s general policy on productivity?

A. The Commission has a long-standing policy of imputing a productivity adjustment, which is intended to capture unidentified productivity gains, efficiencies and cost savings that could be realized in the rate year. The standard productivity adjustment is not intended to capture savings associated with a particular program. This adjustment for KEDNY and KEDLI is typically calculated at 1% of total labor expense and payroll taxes.

Q. Does the Panel recommend a different productivity adjustment?

A. Yes. We recommend a 2% productivity adjustment.

Q. Please explain the basis for this increase to the productivity adjustment.

A. There are a number of reasons to support a 2% productivity adjustment at this time. First, as discussed in the testimony of Company Witness Heaphy and Exhibit __ (MPH-1CU), the Companies have projected an additional 393.4 incremental FTEs, with 110.2 at KEDLI, 241.3 at KEDNY and 42 at the Service Company. The Companies project that all of these incremental employees will be hired before the start of the rate year. The Companies did not recognize additional productivity gains resulting from the additional employees, outside of the 1%. The incremental employees the Company is hiring should be expected to improve in the near future as their work experience grows. As the employees gain experience, productivity should increase as well. Second, the Companies will be implementing a number of new initiatives, as discussed in testimony of the Companies’ Revenue Requirement Panel. As part of these new initiatives, the Companies are including three

“Reforming the Energy Vision” (REV) demonstration projects, as Company Witness Mongan discusses. Also included in these new initiatives are gas growth marketing costs, economic development costs, and utilization technology development costs.

Q. Do any other Staff witnesses provide support for an increase in the productivity adjustment?

A. Yes. Staff witness Routhier-James discusses aspects of the Companies’ implementation of management audit recommendations as reason to support increasing the productivity adjustment to greater than 1%.

Q. Has the Commission ever supported a productivity adjustment of greater than 1%?

A. Yes. The Commission has supported a productivity adjustment of greater than 1% in many cases, including the following: Case 93-E-1123, Long Island Lighting Company (issued July 3, 1995); Case 97-G-0409, St. Lawrence Gas Company (issued January 22, 1998); Case 08-E-0539, Consolidated Edison Company of New York, Inc. (issued April 24, 2009); Cases 14-E-0318 & 14-G-0319, Central Hudson Gas and Electric

Corporation (issued April 22, 2015); Cases 15-E-0283 & 15-G-0284, Rochester Gas and Electric Corporation (issued February 19, 2016); and Cases 15-E-0285 & 15-G-0286, New York State Electric & Gas Corporation (issued February 19, 2016).

Q. Have you quantified your adjustment?

A. Yes. The adjustment of the incremental 1% productivity for KEDLI is a downward adjustment of $1.813 million and a downward adjustment of $3.313 million for KEDNY.

<u>Other Initiatives</u>

Q. Does the Panel recommend any adjustments to rate year Other Initiatives expense?

A. Yes. We recommend three adjustments. The first is the quantitative adjustment to the proposed full-time employee reductions and salary reductions supported in the testimonies of Staff Panels and Witnesses Staff Consumer Services Panel, Routhier-James, Staff Gas Infrastructure and Operations Panel, and the Gas Safety Panel. The second is a flow through adjustment to the benefits and payroll taxes related to the previous adjustment category to Other Initiatives. The third adjustment is to increase the productivity adjustment related to incremental employees to 2%.

Q. How did the Companies calculate the proposed expenses related to the incremental employees within this line item?

A. As part of the Other Initiatives expense, the Companies included a combined 393.4 incremental employees related to new capital projects and initiatives. The costs for these incremental employees include base salary, benefits, variable pay, taxes, and productivity.

Q. Please explain the first adjustment.

A. The first adjustment reduces the total FTE count to 376, down from 393.4, as recommended in the testimonies of Staff witnesses Routhier-James, the Staff Consumer Services Panel, Gas Safety Panel, and Staff Gas Infrastructure and Operations Panel (SGIOP). Additionally, this adjustment factors in the recommended reduction of salaries for the positions referenced by the SGIOP. This results in a downward adjustment of $4.315 million for KEDNY, and $1.021 million for

KEDLI.

Q. Please explain the second adjustment.

A. We make flow through adjustments to capture the impact on benefits and payroll taxes associated with the first adjustment proposed to the incremental employees in Other Initiatives. This results in a downward adjustment of $2.242 million for KEDNY, and of $652,579 for KEDLI.

Q. Please explain the third adjustment.

A. We reflect the impact of our 2% productivity adjustment on the Other Initiatives incremental employees labor and payroll tax expense. This incremental 1% adjustment results in an upward adjustment of $12,734 for KEDNY, and an upward adjustment of $5,948 for KEDLI.

Q. Explain what the Company included in their calculation of productivity.

A. The Companies proposed a 1% productivity factor on labor, benefits, and payroll taxes on these incremental employees.

Q. Does the Panel agree with this calculation?

A. No. We propose to not include benefits in the calculation. Using the same rationale and methodology as discussed earlier with regard to the productivity adjustment based on existing employees, we feel a rate of 2% is reasonable. Additionally, we recommend that the methodology of calculating productivity should be uniform for the Companies.

<u>Regulatory Assessment Fees</u>

Q. Please describe the regulatory assessment fees.

A. Section 18-a of New York State's Public Service Law provides for recovering the total costs of the Public Service Department and Commission from regulated public utility companies. The assessment consists of two components – the General and Energy Research and Development Authority ("ERDA") Assessments and the Temporary State Energy and Utility Service Conservation Assessment ("18-A Assessment"). Pursuant to Public Service Law 18-a(6), the Commission bills utilities twice a year. Once in February, and once August for the General and Temporary assessment. The initial February billing is based on an estimate of a utility's intrastate revenues from the prior fiscal year. In August, a revised bill is rendered with an adjusted assessment amount based on actual intrastate revenues. In addition the revised August bill includes the “ERDA” assessment.

Q. What are the Companies’ Regulatory Assessment rate year forecasts?

A. KEDNY and KEDLI forecasted rate year General Assessment fees of $3.933 million, and $2.425 million, respectively.

Q. Do you propose any adjustments to KEDNY’s and KEDLI’s forecasts of regulatory commission assessment fees for the rate year?

A. Yes. We recommend that the expense be updated for the latest General Assessment amounts reflected in the 2016 February billings, plus inflation.

Q. What are the 2016-2017 billing amounts?

A. KEDNY and KEDLI were billed $3.458 million and $2.421 million for the General Assessment in the initial February billing.

Q. Please explain how you calculated their adjustments.

A. We used the 2016 billing amounts, plus the rate of 1.35%, reflecting inflation from April 1, 2017 through the end of the rate year, December

31, 2017 to arrive at our rate year forecast.

Q. Why did you apply inflation from April 1, 2017 through December 31, 2017?

A. The 2016 billing amounts are for the time period from April 1, 2016 through March 31, 2017. These amounts represent the actual costs during that time period. To reflect the expected general increase in costs for the ensuing period, we applied inflation from April 1, 2017 through December 31, 2017.

Q. Please quantify this adjustment.

A. Our adjustment decreases KEDNY's forecast by $428,000, and increases KEDLI's forecast by $29,000, respectively.

Carrying Charges

Q. Are KEDNY and KEDLI proposing to modify the carrying charges applicable to deferral balances?

A. Yes. Currently, both Companies apply carrying charges to their respective deferred balances using the Allowed Funds Used During Construction rate. The Companies believe the pre-tax weighted average cost of capital (pre-tax WACC) is a more appropriate rate to apply to the deferral balances.

Q. Do you agree that the carrying charge applied to deferral balances should be the pre-tax WACC?

A. Yes. The pre-tax WACC is a more appropriate rate to apply to deferral balances. In addition, this treatment is utilized by the Companies’ affiliate Niagara Mohawk Power Corporation d/b/a National Grid.

Q. Does this conclude the Panel’s testimony at this time?

A. Yes.