

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Niagara Mohawk Power Corporation

Cases 12-E-0201 and 12-G-0202

August 2012

Prepared Testimony of:

Staff Accounting Panel

Richard M. Davi
Allison A. Esposito
Denise A. Gerbsch
Gerry W. Wojcinski

State of New York
Department of Public Service
Three Empire State Plaza
Albany, New York 12223-1350

1	Table of Contents	
2	I. Expenses.....	17
3	A. Consultant Expense	17
4	B. Other Expenses	24
5	1. Industry Association Dues.....	24
6	2. Normalizing Adjustments.....	27
7	C. Rents	37
8	1. Reservoir Woods	37
9	2. Service Company Return on Assets	46
10	D. Materials – Outside Vendor	48
11	E. Labor	49
12	1. Percentage of Labor Capitalized	49
13	2. Percentage of Variable Pay Capitalized	57
14	3. Management Compensation Adjustments	59
15	4. Other Labor Adjustments	60
16	F. Fringe Benefits	61
17	1. Percentage of Employee Benefits Capitalized..	61
18	2. Other Fringe Benefits Adjustments	65
19	G. Productivity	66
20	H. Uncollectible Accounts	66
21	I. US Restructuring Savings	76
22	J. E&Y Analysis	79
23	K. Expatriate Proxy	88
24	L. Allocation Reclass	96

1	M. IS Transformation Initiative	101
2	N. Inflation Factor Update.....	110
3	II. Taxes Other Than Income Taxes.....	114
4	A. Property Taxes	114
5	B. Payroll Taxes	120
6	III. Rate Year Deferrals.....	121
7	A. Overview – Electric Deferrals	121
8	B. Overview – Gas Deferrals	125
9	C. Pre-Rate Year Deferrals	129
10	1. Federal Income Taxes – Repair Costs	129
11	2. Carrying Charges on Pre-Rate Year	
12	Deferrals	140
13	3. Audit of Pre-Rate Year Deferrals.....	141
14	IV. Service Company Costs.....	142
15	V. Overland Audit.....	172
16		
17		
18		
19		
20		
21		
22		
23		
24		

1 Q. Staff Accounting Panel, would you please state
2 your names and business addresses.

3 A. Richard M. Davi, Allison A. Esposito, Denise A.
4 Gerbsch, Gerry W. Wojcinski. Our business
5 address is New York State Department of Public
6 Service (DPS), 3 Empire State Plaza, Albany, NY
7 12223.

8 Q. Mr. Davi, by whom are you employed and in what
9 capacity?

10 A. I am employed by the Department of Public
11 Service as a Public Utilities Auditor III in the
12 Office of Accounting and Finance.

13 Q. Ms. Esposito, by whom are you employed and in
14 what capacity?

15 A. I am employed by the Department of Public
16 Service as a Public Utilities Auditor III in the
17 Office of Accounting and Finance.

18 Q. Ms. Gerbsch, by whom are you employed and in
19 what capacity?

20 A. I am employed by the Department of Public
21 Service as a Supervisor - Utility Accounting &
22 Finance in the Office of Accounting and Finance.

23 Q. Mr. Wojcinski, by whom are you employed and in
24 what capacity?

1 A. I am employed by the Department of Public
2 Service as a Public Utilities Auditor III in the
3 Office of Accounting and Finance.

4 Q. Mr. Davi, please summarize your education and
5 work experience.

6 A. I received a Bachelor of Business
7 Administration, with a concentration in
8 Accounting, from Siena College in 1986. I am a
9 certified public accountant in New York State.
10 From 1986 to 1989 I was employed as a staff
11 accountant for a local accounting firm. In May
12 1989, I joined the Department of Public Service
13 in the Office of Accounting and Finance where I
14 have been employed for the past 23 years. I
15 have testified in numerous rate proceedings
16 before the Commission regarding various revenue
17 requirement and ratemaking issues, including
18 rate of return. The list of cases includes Case
19 08-G-0609, the Company's most recent gas case.

20 Q. Ms. Esposito, please summarize your education and
21 work experience.

22 A. I received a Master's degree in Accounting in
23 2004 from the State University of New York at
24 Albany. I also received a Bachelor's degree in

1 Government from Cornell University in 2001. I
2 am a certified public accountant in New York
3 State. From July 2004 through May 2007, I
4 worked as an auditor for PricewaterhouseCoopers
5 in Albany, NY. In this position, I performed
6 financial statement audits and Sarbanes-Oxley
7 compliance audits for a number of companies in
8 various industries. From May 2007 through May
9 2008, I supervised the expenses' department at
10 the Golub Corporation in Schenectady, NY. I
11 joined the Department of Public Service in May
12 2008. Since that time, I have testified in Case
13 08-G-1392, St. Lawrence Gas, and Case 10-E-0050,
14 Niagara Mohawk Power Corporation.

15 Q. Ms. Gerbsch, would you please summarize your
16 education and work experience.

17 A. I graduated from the State University of New
18 York at Oswego in May 1988 with a Bachelor of
19 Science degree in Accounting. Since June 1988,
20 I have been employed by the Department of Public
21 Service in the Office of Accounting and Finance.
22 During this 24 year period, the vast majority of
23 my time has been spent on accounting and
24 ratemaking issues involving Niagara Mohawk,

1 including rate cases, deferral petitions, fuel
2 adjustment clause audits, commodity adjustment
3 clause audits, transmission revenue adjustment
4 clause audits, financings, refunds, and retail
5 access issues. I also testified in Cases 08-G-
6 0609 and 10-E-0050, the Company's most recent
7 gas and electric cases.

8 Q. Mr. Wojcinski, please summarize your education
9 and work experience.

10 A. I graduated from Canisius College in 1972 with a
11 Bachelors Degree in Business Administration,
12 with a major in Accounting. From January 1973
13 to April 1974, I was employed as an Assistant to
14 the Comptroller at the Wurlitzer Company.
15 Thereafter, I joined the Staff of the Department
16 of Public Service. Since that time I have
17 participated in numerous utility accounting
18 examinations including rate proceedings, finance
19 cases and a merger. More recently, I have
20 submitted testimony in the following rate
21 proceedings: Case 07-G-0141, National Fuel Gas
22 Distribution Corporation - Gas Rates, Case 08-G-
23 0609, Niagara Mohawk Power Corporation - Gas
24 Rates and in Case 08-G-1392 St Lawrence Gas

1 Company Inc.

2 Q. Panel, what is the scope of your testimony in
3 this proceeding?

4 A. We are testifying on: (1) numerous expense cost
5 components; (2) taxes other than income taxes;
6 (3) the Company's forecast of pre-rate year
7 regulatory deferrals and the deferrals the
8 Company has requested for the rate year ending
9 March 31, 2014, and (4) service company issues
10 associated with Niagara Mohawk. In terms of
11 presentation and organization, we will address
12 and discuss the issues in a manner which best
13 follows the Company's income statement in
14 Exhibit ____ (RRP-1CU), with any revenue issues
15 addressed first, followed by expenses, etc.
16 However, we note that there are some revenue,
17 expense and rate base issues that overlap or are
18 related to one another. In those instances, we
19 will group the issues together rather than
20 following the Company's income statement. We
21 will also include an additional "Miscellaneous"
22 expense cost component to the Company's income
23 statement for those Staff adjustments which
24 involve more than one cost component.

1 In addition, we are sponsoring Staff's
2 overall revenue requirement exhibit.

3 Q. How many exhibits are you sponsoring?

4 A. We are sponsoring five exhibits.

5 Q. Would you briefly describe Exhibit ____ (SAP-1)?

6 A. Exhibit ____ (SAP-1) is Staff's rate year electric
7 cost of service presentation, consisting of six
8 schedules. Schedule 1 summarizes Staff's
9 projection of electric operating income, rate
10 base and rate of return for the rate year ending
11 March 31, 2014. Schedule 1 is supported by
12 Schedules 2 through 6.

13 Q. Please describe the format of Schedule 1.

14 A. Column 1 of Schedule 1 contains the rate year
15 income statement, rate base and rate of return
16 figures per Exhibit ____ (RRP-1CU) of the
17 Company's Corrections and Updates filing, before
18 any required base rate increase. Column 2
19 contains Staff's proposed adjustments to the
20 Company's rate year projections. Column 3
21 presents Staff's as adjusted rate year
22 projections before any required base rate
23 increase. Column 4 contains Staff's proposed
24 overall revenue requirement adjustment. Column

1 5 is Staff's forecasted rate year income,
2 expenses, rate base and rate of return after the
3 revenue requirement decrease is reflected.

4 Q. What information is shown on Schedules 2, 3 and
5 4 of Exhibit ____ (SAP-1)?

6 A. Schedule 2 breaks down Staff's forecast of rate
7 year electric O&M expense by cost element,
8 similar to the Company's Exhibit ____ (RRP-3CU).
9 Schedule 3 shows Staff's forecast of rate year
10 electric federal income taxes, similar to the
11 Company's Exhibit ____ (RRP-6CU). Schedule 4
12 presents Staff's forecast of rate year rate
13 base, by component, similar to the Company's
14 Exhibit ____ (RRP-7CU).

15 Q. What information is shown on the remaining two
16 schedules of Exhibit ____ (SAP-1)?

17 A. Schedule 5 provides the derivation of Staff's
18 recommended rate year weighted cost of capital,
19 and Schedule 6 is a summary level description of
20 each of Staff's electric revenue, expense and
21 rate base adjustments.

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

23 A. Exhibit ____ (SAP)-2 is Staff's rate year gas cost
24 of service presentation, consisting of six

1 schedules. Similar to Exhibit ____(SAP-1),
2 Schedule 1 summarizes Staff's projection of gas
3 operating income, rate base and rate of return
4 for the rate year ending March 31, 2014.
5 Schedule 1 is supported by Schedules 2 through
6 6.

7 Q. Please describe Exhibits ____(SAP-3) and (SAP-
8 3conf)?

9 A. Exhibit__ (SAP-3) contains the information
10 requests, IR, responses referenced in the Staff
11 Accounting Panel testimony as well as in the
12 testimony of all other Staff witnesses and Staff
13 panels. Exhibit ____(SAP-3Conf), includes the
14 confidential IR responses referenced in Staff's
15 testimony.

16 Q. How are IRs numbered in your testimony and in
17 your exhibits?

18 A. In our testimony, as well as in the testimony
19 and exhibits of all Staff witnesses and Staff
20 panels, when reference is made to an IR, both
21 the DPS and the Staff assigned IR number will be
22 provided in the following manner, using Ms.
23 Gerbsch's twenty-second IR for illustration
24 purposes: DPS-149 (DAG-22). In our Exhibit

1 ____(SAP-3), the Company's IR responses are in
2 DPS numerical order.

3 Q. Have you included the Company's entire responses
4 to the various IRs in your exhibits?

5 A. Not in all cases. Due to the voluminous nature
6 of some of the responses, we have only included
7 those pages of the responses we deemed relevant.
8 To the extent the Company or any other party
9 believes we may have omitted anything of further
10 relevance, they can supplement the record with
11 the additional information. This also applies
12 to the IR responses referenced in the testimony
13 of all Staff witnesses and Staff panels.

14 Q. Please briefly describe Exhibit ____(SAP-4).

15 A. Exhibit ____(SAP-4) is a compilation of Staff's
16 workpapers used to support our proposed
17 adjustments.

18 Q. Would you briefly describe Staff's audit of the
19 Company's filing in this rate case?

20 A. Staff conducted a rigorous audit within the
21 timeframe allowed in this case. We reviewed the
22 company's voluminous filings, submitted over 500
23 IRs, many of which contained multiple parts, and
24 we held numerous meetings with Company employees

1 to gain greater clarity on a multitude of
2 different issues.

3 Q. Would you please summarize Staff's
4 recommendation regarding the Company's requested
5 electric revenue requirement?

6 A. In its April 27, 2012 initial filing, the
7 Company requested a \$130.7 million base rate
8 increase. In its July 16, 2012 Corrections and
9 Updates filing, the Company increased its
10 requested base rate increase to \$145.4 million,
11 as stated on page 3 of the Company's Revenue
12 Requirements Panel's supplemental testimony.
13 Staff is recommending an electric base rate
14 decrease of approximately \$11 million, or
15 approximately \$156 million less in revenues than
16 the amount requested by the Company. Exhibit
17 ____ (SAP-1), Schedule 6 lists every adjustment
18 Staff is proposing that makes up this \$156
19 million revenue requirement differential, with
20 the exception of Staff's return on equity and
21 capital structure adjustments.

22 Q. Would you please summarize Staff's
23 recommendation regarding the Company's requested
24 gas revenue requirement?

1 A. In its April 27, 2012 initial filing, the
2 Company requested a \$24.516 million base rate
3 increase, offset by an amortization of net gas
4 deferral credits of \$14.104 million, for a net
5 base gas delivery rate increase of \$10.412
6 million. In its July 16, 2012 Corrections and
7 Updates filing, the Company increased its
8 requested gas base rate increase to \$28.984
9 million, as stated on page 3 of the Company's
10 Revenue Requirements Panel's supplemental
11 testimony. This amount is again offset by the
12 amortization of net gas deferral credits, an
13 amount updated to \$14.381 million, resulting in
14 a net base delivery rate increase of \$14.603
15 million. Staff is recommending a gas base rate
16 decrease of approximately \$13 million, or
17 approximately \$42 million less in revenues than
18 the amount requested by the Company. At this
19 time, Staff recommends no amortization of the
20 projected deferred credit balance of \$41 million
21 as shown on Exhibit __ (RRP-7CU). If however,
22 the Commission's ultimate decision results in a
23 rate increase, we would recommend amortizing a
24 portion of the deferred credit balance as an

1 offset. Exhibit ____ (SAP-2), Schedule 6 lists
2 every adjustment Staff is proposing that makes
3 up this \$42 million revenue requirement
4 differential, with the exception of Staff's
5 return on equity and capital structure
6 adjustments.

7 Q. Would you briefly summarize the major reasons
8 for the \$156 million difference in the electric
9 rate year revenue requirement?

10 A. The largest difference, by far, is due to the
11 Company's request for a 10.55% return on equity
12 and an equity ratio of 51%, compared to Staff's
13 recommended 8.9% return on equity and 48.0%
14 equity ratio. We estimate these cost of money
15 issues account for approximately \$80 million of
16 the \$156 million difference. Other major
17 differences include: (1) approximately \$23
18 million related to Staff's sales forecast
19 recommendations; (2) \$12 million related to
20 Staff's labor expense recommendations; (3)
21 approximately \$8 million for Staff's property
22 tax recommendations; and (4) approximately \$7
23 million related to the uncollectibles accounts
24 expense allowance.

1 Q. Would you briefly summarize the major reasons
2 for the \$42 million difference in the gas rate
3 year revenue requirement?

4 A. Again, the largest difference, by far, is due to
5 the Company's request for a 10.55% return on
6 equity and an equity ratio of 51%, compared to
7 Staff's recommended 8.9% return on equity and
8 48.0% equity ratio. We estimate these cost of
9 money issues account for approximately \$20
10 million of the \$40 million difference. Other
11 major differences include: (1) \$6 million for
12 Staff's depreciation expense adjustment; (2) \$2
13 million related to Staff's labor expense
14 recommendations; (3) approximately \$2 million
15 for Staff's property tax recommendations; and
16 (4) approximately \$5 million related to
17 uncollectible accounts expense allowance.

18 Q. Do you have any general comment on the Company's
19 filing?

20 A. Yes. While overall the Company's April 27, 2012
21 rate filing was adequate in presentation and
22 support, there are some specifically
23 identifiable areas the Company needs to improve
24 on in future rate filings. Three such areas

1 are, (1) review of historic test year costs, (2)
2 Information Services (IS) historic year costs
3 and projected future costs, and (3) federal and
4 state income tax historic year and projected
5 rate year expenses. In each of these areas, we
6 had difficulties in auditing the Company's rate
7 year request. With respect to historic year
8 costs, there were some cost areas where, only
9 after Staff began its auditing and review
10 process, it became apparent the Company had not
11 undertaken the necessary proper review to
12 determine whether the historic test year actual
13 costs needed to be normalized or not in
14 formulating the rate year projections. Two very
15 clear examples are the IS Transformation and
16 expatriate costs, which are both addressed in
17 detail in the testimony that follows.

18 Q. Please continue.

19 A. Another example relates to the federal and state
20 income tax expense areas, where the Company
21 failed to provide the detailed historic and link
22 period information needed for us to determine if
23 the rate year level is correct. This is basic
24 information the Company should know is necessary

1 in order for us to understand and verify its
2 calculations. Instead, several IRs were needed
3 to obtain this basic data. We remind the
4 Company it should be including in its rate
5 filing, historic test year balance sheets,
6 income statements, and complete federal and
7 state income tax calculations. This would
8 include detailed information for all items such
9 as Schedule M deductions and additions, tax
10 rates applicable to derive taxable income and
11 tax expense, deferred tax expense items that
12 reconcile to Schedule M items, etc.

13 Q. Would you please begin explaining your proposed
14 adjustments to the Company's rate case filing?

15 A. Yes. We will address the issues in the
16 sequential order we previously described.

17

18 **I. Expenses**

19 **A. Consultant Expense**

20 Q. Are you making adjustments to cost element #100
21 Consultant expense?

22 A. Yes, we are recommending four normalizing
23 adjustments be made to the rate year projection
24 of Consultant O&M expense for charges incurred

1 in the historic test year that, after review,
2 appear to be one-time expenses and not of a
3 recurring nature.

4 Q. What information did Staff rely upon to derive
5 the normalization adjustments recommendation?

6 A. Staff used the information provided by the
7 Company in its response to IRs DPS-88 (DAG-8),
8 DPS-446 (DAG-59), and DPS-452 (DAG-62).

9 Q. What did the Company's responses to IR DPS-88
10 (DAG-8), DPS-446 (DAG-59), and DPS-452 (DAG-62)
11 consist of?

12 A. As can be seen from the Company's Revenue
13 Requirements Panel's Exhibit __ (RRP-3CU)
14 Schedule 1, Page 5 of 5, in deriving the rate
15 year forecast, the Company begins with the
16 historic test year actual and removes charges
17 considered non-recurring through the test year
18 analysis review, and also normalizes out various
19 buckets of costs that are included in other cost
20 elements presented on the income statement, such
21 as SBC costs, legal expense, accounting
22 expenses, etc. The Company then applies an
23 inflation factor of 4.2785% to the remaining
24 normalized historic test year base to determine

1 the rate year forecast. IR DPS-88 (DAG-8) asked
2 the Company to provide detailed cost
3 information, i.e. by activity number, by vendor,
4 and by individual journal entries, for each of
5 the cost buckets that were normalized out, as
6 well as the remaining bucket of historic year
7 consultant expenses that the inflation factor
8 gets applied to. The historic test year charges
9 that remain are shown in the Company's response
10 to IR DPS-88 (DAG-8) Attachment 7. We then
11 followed up with IRs DPS-446 (DAG-59) and DPS-
12 452 (DAG-62) and requested the Company provide
13 the detail for a list of sample charges derived
14 from the Company's earlier response to IR DPS-88
15 (DAG-8).

16 Q. Please explain your first adjustment.

17 A. The Company's response to IR DPS-446 (DAG-59)
18 identifies as being normalized and removed from
19 the historic test year charges from Overland
20 Consulting Inc. for work performed on the audit
21 of National Grid's affiliate cost allocations,
22 policies and procedures from Case 10-M-0451.
23 Although the Company is correct that it removed
24 some of the historic year Overland Consulting

1 charges, based on the Company's response to IR
2 DPS-88 (DAG-8), Attachment 7, there remains a
3 portion of Overland charges in the historic test
4 year base. Specifically, costs related to
5 Overland invoices # 854-857, 861-862, and 865-
6 866 need to be removed.

7 Q. Why should these costs be removed?

8 A. These are one-time costs incurred for a special
9 audit, and are not expected to be of a recurring
10 nature in the rate year. In addition, in IR
11 DPS-446 (DAG-59) Attachment 1, the Company has
12 stated these costs were supposed to be removed,
13 but were inadvertently not captured for removal.

14 Q. What is Staff's adjustment?

15 A. Staff is removing historic year costs of
16 \$172,765 plus an inflation amount of \$7,392, for
17 a total adjustment of \$180,157 (\$153,866 for
18 electric; \$26,291 for gas).

19 Q. What is Staff's next adjustment?

20 A. The second adjustment, similar in nature to the
21 Overland Consulting charges, relates to the
22 Company response to IR DPS-446 (DAG-59) and its
23 identification that historic year charges from
24 Capgemini Technologies have been removed. The

1 Capgemini charges referred to here are in
2 invoice #8104011012366 for work done on Project
3 Marlborough, Phase 1 high level design. Project
4 Marlborough is also known as the US
5 Restructuring Program, which was a one-time
6 special project, not expected to recur in the
7 rate year. Here, too, the Company removed some
8 of the historic year Capgemini charges but,
9 based on the Company's response to IR DPS-446
10 (DAG-59), Attachment 7, there are \$123,521 of
11 electric expense costs still in the historic
12 test year base.

13 Q. What is Staff's adjustment?

14 A. Staff is removing \$123,521 plus an added
15 inflation amount of \$5,285, for a total of
16 \$128,806 removed from the forecasted consultant
17 expense, electric only, for the rate year.

18 Q. Please explain Staff's third adjustment.

19 A. The second adjustment discussed above, removed
20 historic year Capgemini consulting costs that
21 were charged through the National Grid
22 Peoplesoft accounting system. There are
23 additional Capgemini consulting costs charged
24 through the legacy KeySpan Oracle system that

1 need to be removed from the historic test year
2 base as well, for the same reasons as discussed
3 above. Specifically, the Capgemini charges
4 coming through the Oracle system that should be
5 removed are in invoice #8104011011509, and are
6 for work done on the US Restructuring program
7 initiative. Based on the Company's response to
8 IR DPS-452 (DAG-62), Attachment 1, there are
9 \$117,142 of total expense costs still in the
10 historic test year base. Staff is removing
11 \$117,142 plus an added inflation amount of
12 \$5,012, for a total of \$122,154 removed from the
13 forecasted consultant expense (\$101,388 for
14 electric; \$20,766 for gas).

15 Q. Please explain Staff's next adjustment.

16 A. The Company incurred costs in the historic year
17 for PA Consulting, a firm which performed the
18 cost allocation review described in Exhibit __
19 (SCP-6) and whose results provide the
20 recommended new allocators to be implemented by
21 the Company as shown in Exhibit __ (SCP-7).
22 These costs should be removed from the historic
23 test year base the Company uses to project the
24 rate year.

1 Q. Why should these costs be removed?

2 A. These costs are for a one-time special project;
3 a project that, based on the nature of the
4 project, should not be recurring in the rate
5 year. No supporting information that would
6 indicate otherwise has been provided by the
7 Company.

8 Q. What is Staff's adjustment?

9 A. The Company incurred historic year costs of
10 \$93,755 electric expense and \$16,017 gas expense
11 for invoices #10017674, 10017784, 10017900,
12 10017961 and 1008117. These costs should be
13 increased for the inflation factor of 4.2785%,
14 resulting in a total reduction to rate year
15 consultant expense of \$114,468 (\$97,766 for
16 electric; \$16,702 for gas).

17 Q. Do you have additional comments relating to
18 consultants expense?

19 A. Yes, we have submitted a follow up IR, IR DPS-
20 523 (DAG-91), on specific journal entry #99614-
21 06EB that contains charges for consultant
22 expense in the historic test year. We are
23 awaiting a response to that IR to understand the
24 reason for the charges and to determine if a

1 normalizing adjustment is required to remove the
2 charges from the historic test year base because
3 the charges are shown to be of a non-recurring
4 nature.

5 **B. Other Expenses**

6 **1. Industry Association Dues**

7 Q. Has the Company included any amounts in the rate
8 year forecast for industry association dues?

9 A. Yes, the Company has included \$168,385 in the
10 rate year for annual American Gas Association
11 (AGA) dues, \$52,775 for annual Northeast Gas
12 Association (NGA) dues, and \$425,511 for Edison
13 Electric Institute (EEI) dues in expense type
14 400 - Other Expense.

15 Q. Is there any Commission precedent or policy on
16 allowing recovery of industry association dues
17 in rates?

18 A. Yes. In previous Niagara Mohawk as well as
19 other utilities' rate proceedings, the
20 Commission has allowed only half of industry
21 association dues to be included in rates.
22 Specifically, this issue was addressed in
23 Niagara Mohawk Cases 28798, 28799 and 28800,
24 Opinion No. 85-4, Opinion and Order Determining

1 Revenue Requirement and Rate Design, issued
2 March 14, 1985; Cases 29069 and 29070, Opinion
3 No. 86-6, Opinion and Order Determining Revenue
4 Requirement and Rate Design, issued March 12,
5 1986; Cases 29327 and 29328, Opinion No. 87-3,
6 Opinion and Order Determining Revenue
7 Requirement and Rate Design, issued March 13,
8 1987; Cases 93-G-0162, 93-E-0376 and 93-E-0378
9 Opinion No. 94-13, Opinion and Order Approving
10 Electric Settlement Agreements With a Change and
11 Determining Gas Revenue Requirement and Rate
12 Design, issued May 12, 1994. On page 40 of
13 Opinion No. 94-13, the Commission ruled that an
14 explicit adjustment disallowing the portion of
15 AGA dues associated with lobbying must be made
16 in order for rates to be consistent with "an
17 agency policy concerning AGA dues expressed in a
18 series of rate decisions and a state law [PSL
19 S114-a] prohibiting the recovery in rates of
20 lobbying expenses." Q. Has the Company set
21 forth any evidence in this case as to what
22 percentage of dues for AGA, NGA or EEI are
23 related to lobbying?

24 A. The Company has not provided any testimony or

1 exhibits supporting its full rate request for
2 the AGA, NGA or EEI dues. In IR DPS-505 (DAG-
3 87), the Company was asked to provide copies of
4 all invoices with supporting documentation for
5 the charges paid in the historic year for AGA,
6 NGA and EEI charges. The Company's response
7 included a copy of the "request for check" to
8 pay each invoice, and the associated invoice for
9 each membership's annual dues. As part of
10 supplemental response to IR DPS-440 (DAG-56),
11 the Company provided additional information;
12 letters from the AGA and NGA that were part of
13 the invoice initially received. While there is
14 some description of the activities funded by the
15 membership dues, it is not clear what percentage
16 of dues is lobbying related.

17 Q. Is there any other information the Company has
18 failed to provide for its membership in these
19 industry associations?

20 A. Yes, in Opinion No. 85-4, the Commission stated
21 "In future cases, we shall expect the company to
22 make a better presentation on the benefits
23 enuring to ratepayers from its membership in
24 both EEI and the American Gas Association

1 (AGA)." The Company, in the current electric
2 and gas rate case, provides no explanation or
3 description of any resulting ratepayer benefits
4 from its membership in these industry
5 associations.

6 Q. What is your recommendation concerning the
7 annual dues for the AGA, NGA, and EEI
8 memberships?

9 A. Consistent with past Commission precedent and
10 policy, we recommend disallowing 50% of the
11 annual AGA, NGA, and EEI dues. A total
12 adjustment, in the amount of \$323,336 (-\$212,756
13 for electric; -\$110,580 for gas), reflects this
14 recommendation.

15 **2. Normalizing Adjustments**

16 Q. Are you making any additional adjustments to
17 cost element #400 "Other" expense?

18 A. Yes, we are recommending four normalizing
19 adjustments be made to the rate year projection
20 of Other O&M expense for charges incurred in the
21 historic test year that, after review, appear to
22 be one-time expenses and not of a recurring
23 nature.

24 Q. What information did Staff rely upon to derive

1 the normalization adjustments recommendation?

2 A. Staff used the information provided by the
3 Company in its responses to IRs DPS-112 (DAG-14)
4 and DPS-440 (DAG-56).

5 Q. What did the Company's responses to IR DPS-112
6 (DAG-14) and DPS-440 (DAG-56) consist of?

7 A. The Company defines the costs that get charged
8 to cost element #400, Other expense, as expenses
9 that do not get accounted for elsewhere.
10 Similar to its projection of rate year
11 consultant expense (cost type #100), the
12 Company derives the rate year forecast beginning
13 with the historic test year actual, then removes
14 charges considered non-recurring through the
15 test year analysis review, and also normalizes
16 out many buckets of costs that are included in
17 other cost elements presented on the income
18 statement. The Company then applies an
19 inflation factor of 4.2785% to determine the
20 rate year forecast. IR DPS-112 (DAG-14) asked
21 the Company to provide detailed cost
22 information, i.e. by activity number, by vendor,
23 and by individual journal entries, for each of
24 the cost buckets that were normalized out, as

1 well as the remaining bucket of historic year
2 "Other" expenses that the inflation factor gets
3 applied to. Staff followed up with IR DPS-440
4 (DAG-56) and requested the Company provide the
5 detail for a list of sample charges derived from
6 the Company's earlier response to IR DPS-112
7 (DAG-14).

8 Q. Please explain your first adjustment.

9 A. The Company incurred two charges for vendor
10 Equisales of \$391,500 (invoice # 24400, dated
11 10/6/2011) and \$43,500 (invoice #24412, dated
12 10/26/2011). Equisales is a company that
13 provides time-critical high voltage transformers
14 and substation equipment. The two charges were
15 associated with power transformers for the
16 Company's Amsterdam, New York temporary
17 substation that was under construction in the
18 fall of 2011. Due to the damage caused by
19 Hurricane Irene in August 2011 and Tropical
20 Storm Lee in September 2011, the Company's
21 Amsterdam substation was damaged beyond repair.
22 As a result, the Company first constructed a
23 temporary mobile substation, followed by a
24 temporary substation to replace the use of a

1 mobile substation. It was the Company plan to
2 then build a new substation in the vicinity of
3 the temporary station for long term use.
4 Equisales' charges were associated with the
5 temporary substation effort. The Company has
6 provided no reason these specific historic year
7 Equisales costs, would recur in the rate year.
8 Therefore these costs should be removed from the
9 rate year projection of "Other" expense.
10 Staff's adjustment is \$435,000 plus inflation of
11 \$18,611 for a total reduction to electric O&M
12 expense of \$453,611.

13 Q. Please explain your second adjustment.

14 A. Our second adjustment is for a journal entry
15 cost identified as #PAFY11RES, with a historic
16 year charge to electric Other expense of
17 \$1,074,393 and gas Other Expense of \$348,663.
18 In response to IR DPS-440 (DAG-56), the Company
19 provided seven pages of a March 2011 journal
20 entry that has a description of "PA reserve
21 fiscal yr end 11 reserves," with a depreciation
22 reserve adjustment calculation. The calculation
23 shows the charges are for write-offs for (1) low
24 dollar work orders less than \$1,000 for legacy

1 National Grid companies and \$2,500 for KeySpan
2 companies, and (2) construction completed not
3 closed less than \$1,000 for legacy National Grid
4 companies. The Company has provided no other
5 information, explanation, description or any
6 analysis that would indicate whether these types
7 of write-offs are of such a recurring nature
8 that they would again be incurred in the rate
9 year, or that the write-offs even relate to the
10 historic test year period, calendar year 2011.
11 These costs should be normalized out of the
12 historic test year base that is used to project
13 rate year expense. Staff's adjustment removes
14 the actual historic test year amounts, increased
15 for inflation of 4.2785%, and results in a total
16 reduction of \$1,483,942 (\$1,120,361 for electric
17 expense; \$363,581 for gas expense).

18 Q. What is Staff's third adjustment?

19 A. The Company includes a charge in the historic
20 test year for a March 2011 journal entry,
21 #99618DS21, with the amount charged to electric
22 Other expense of \$1,097,939 and gas Other
23 expense of \$224,879. The journal entry
24 documentation provided by the Company describes

1 the charges as service company tax adjustments
2 related to fiscal year 2011. These historic
3 year charges should be normalized out of the
4 historic year base used to project the rate year
5 expenses for two reasons. First, the Company
6 has provided no analysis or additional
7 information that would support the determination
8 that these journal entry charges- both the type
9 of adjustments they are and the amounts- are of
10 such a recurring nature that they would again be
11 incurred in the rate year, or, since the charge
12 is for fiscal year 2011, that the charges even
13 relate to the historic test year period.

14 Q. What is the second reason for disallowing this
15 charge?

16 A. The Company has stated in response to IR DPS-366
17 (DAG-43) that all service company costs related
18 to service company equity, tax and debt costs,
19 should be normalized out to avoid a double
20 count, as these type of costs are reflected
21 elsewhere in the Company's rate case
22 presentation.

23 Q. Where are all the projected rate year service
24 company equity, tax and debt costs reflected?

1 A. According to the Company's response to IR DPS-
2 366 (DAG-43), in the current rate case
3 presentation, these particular service company
4 costs are included as a return on service
5 company plant assets net of deferred taxes in
6 the calculation of forecast rent expense.

7 Q. Did the Company make any adjustments to its rate
8 case filing to make sure there were no double-
9 counts of service company equity, tax and debt
10 costs?

11 A. Yes, the Company realized it had included some
12 net credits for those items in cost elements
13 #A20, Service Company Equity, and #A65, Service
14 Company Operating Costs. Therefore, in its
15 Corrections & Updates filing, the Company
16 removes the net credits, increasing the rate
17 year O&M expenses by \$1,443,000 for electric
18 expense and \$270,000 for gas expense.

19 Q. What is the difference between cost elements
20 #A20 and #A65?

21 A. The Company explains in IR DPS-89 (DAG-9) that
22 historic year charges to cost element #A20
23 include costs for the fixed return on service
24 company equity (service company income) and the

1 tax expense the service company recorded during
2 the historic test year (service company tax
3 calculation). The charges to cost element #A65
4 are from the monthly journal entries that are
5 posted to reflect the intercompany interest
6 expense related to the service company's debt
7 and income, the income and expense from
8 investments related to employee deferred
9 compensation, and a reversal done in March 2011
10 of some service company taxes that were
11 incorrectly booked to this bill pool earlier in
12 the fiscal year.

13 Q. If service company tax costs are reflected in
14 forecasted rent expense, and the Company
15 normalized out net credits cost elements #A20
16 and #A65, shouldn't the Company also normalize
17 out the service company tax adjustment charge
18 that is reflected as a historic year charge in
19 cost element #400 - Other expense?

20 A. Yes, it should have. It is curious that the
21 Company would book any service company tax
22 adjustment to Other expense since cost elements
23 #A20 for Service Company Equity, and #A65 for
24 Service Company Operating Costs are supposed to

1 be the cost elements that reflect historic year
2 service company equity, tax and debt costs.
3 Here is a prime example of the Company's
4 inadequate review of the historic test year
5 charges and journal entries. Had it done so
6 properly, this journal entry charge for a
7 service company tax adjustment reflected in
8 Other expense, similar to the adjustments made
9 to eliminate the net credits from cost elements
10 #A20 and #A65, would have been adjusted out.

11 Q. What is Staff's adjustment for this item?

12 A. We are removing \$1,379,414 from the Company's
13 rate year projection of Other expense
14 (\$1,144,914 for electric expense; \$234,500 for
15 gas expense). This reflects both the amounts
16 included in the historic test year base that is
17 used to project the rate year, plus an
18 additional amount for the Company's added
19 inflation.

20 Q. Please explain Staff's fourth adjustment to
21 Other expense.

22 A. In projecting its rate year forecast, the
23 Company is including a historic year journal
24 entry charge, journal ID # 99614-17DS, as

1 recurring in the rate year. The only
2 documentation to support this \$627,000 charge is
3 a December 2010 journal entry, provided in
4 response to IR DPS-440 (DAG-56), that is
5 described as a December 2010 accrual for a
6 Verizon credit that was coded to reverse in a
7 subsequent month. The credit was reversed in
8 January 2011. The Company provided nothing
9 more. There is no other information,
10 explanation, description or any analysis that
11 would indicate this journal entry charge is of a
12 recurring nature such that it would again be
13 incurred in the rate year, or that the charge
14 even relates to the historic test year period,
15 calendar year 2011. In addition, due to the
16 lack of supporting documentation, there is no
17 assurance that the type of cost this charge is
18 supposed to represent is not reflected in
19 another cost element-such as consultant,
20 contractor, hardware, or software. Staff has
21 removed \$653,826 (historic year charge of
22 \$627,000, increased for inflation of 4.2785%)
23 from the projected rate year Other O&M expense.
24

1 **C. Rents**

2 **1. Reservoir Woods**

3 Q. Please explain the Company's forecast for rent
4 expense for the Reservoir Woods office building,
5 and the allocation to Niagara Mohawk.

6 A. The leasing costs associated with the Reservoir
7 Woods office building, located in Waltham,
8 Massachusetts, is included within rent expense.
9 In response to IR DPS-157 (CAS-8), the Company
10 indicated the projected rate year rent expense
11 allocation to Niagara Mohawk for Reservoir Woods
12 was derived from bill pool #00603 information.
13 The allocations for this bill pool are based on
14 square footage data, the functional areas that
15 occupy the space, and how employees in those
16 areas allocate their time entry across the
17 business. Using this bill pool produced
18 allocation percentages of 32.016% to Niagara
19 Mohawk electric and 3.993% to Niagara Mohawk
20 gas.

21 Q. How long has the Company been using bill pool
22 #00603 to allocate Reservoir Woods costs?

23 A. The Company in response to IR DPS-443 (CAS-18)
24 states the bill pool #00603 was established in

1 calendar year 2009 to allocate the Reservoir
2 Woods costs, and that the allocation percentages
3 have not changed since initially established.
4 The analysis that was used to determine the bill
5 pool allocations was prepared using the original
6 square footage data from June 2009.
7 Additionally, the Company maintains that the
8 rate year forecast uses the most recent bill
9 pool #00603 allocation percentages as of the
10 time of the filing, and that the percentages did
11 not change from the historic test year.

12 Q. Is it true the allocation percentages of bill
13 pool #00603 have not changed since June 2009?

14 A. No. In response to IR DPS-52 (DAG-5), the
15 Company provided a copy of its accounting manual
16 as well as bill pool information for fiscal
17 years 2010, 2011, 2012 and 2013. The Company is
18 correct that for fiscal years 2010 through 2012,
19 the bill pool #00603 allocations did not change.
20 However, IR DPS-52 (DAG-5) Attachment 4 clearly
21 shows the Reservoir Woods bill pool allocations
22 were modified for fiscal year 2013, a period
23 consisting of April 1, 2012 through March 31,
24 2013.

1 Q. What were the allocation changes taking place
2 for fiscal year 2013?

3 A. The changes from fiscal year 2012 to fiscal year
4 2013 for the Reservoir Woods costs allocation to
5 Niagara Mohawk were a reduction of 8.456% for
6 electric (32.016% to 23.560%), and a reduction
7 of 0.238% for gas (3.993% to 3.755%), or a total
8 reduction of 8.694%.

9 Q. Did the Company provide a new analysis that
10 would support the changes that became effective
11 April 1, 2012, the start of fiscal year 2013?

12 A. No, the Company has not provided that analysis.
13 In IR DPS-443 (CAS-18), the Company was asked if
14 the bill pool allocations for Reservoir Woods
15 had changed, and if not, that it explain why
16 not, considering the significant reduction in
17 employees due to the US Restructuring
18 initiative. The Company was also asked to
19 provide the analysis undertaken by the Company
20 to determine the allocation of Reservoir Woods
21 costs on a post-US Restructuring basis. In
22 response to IR DPS-443 (CAS-18) the Company
23 stated, "Prior to the announcement of
24 restructuring, it was determined that there were

1 no material changes to Reservoir Woods in terms
2 of space and use and therefore the bill pool
3 #00603 did not require a change. With regards
4 to restructuring, it was determined that the re-
5 organization needed to be complete before the
6 bill pool analysis could be updated, if
7 necessary. To date, the Company has not
8 completed this analysis to determine the
9 allocation on a post restructuring basis. As
10 restructuring effected all departments, the
11 Company does not believe that any change in the
12 bill pool would be material."

13 Q. If the Company's accounting information supplied
14 in response to IR DPS-52 (DAG-5) showed
15 allocation percent changes being made to bill
16 pool #00603 effective April 1, 2012, why did the
17 Company indicate in response to IR DPS-443 (CAS-
18 18) that the allocations did not change since
19 being initially established?

20 A. The Company was asked that very question in IR
21 DPS-490 (GRL-32). In its response, the Company
22 states "The allocation percentages of 32.016%
23 and 3.993% contained in the response to DPS-157
24 (CAS-8) were the most up to date information for

1 Reservoir Woods at the time and were used to
2 develop the Rate Year forecast. As indicated in
3 the response to DPS-443 (CAS-18), the Company
4 did not update the allocation percentages
5 because the reorganization had to be finalized
6 before the analysis could be completed. In
7 reviewing the calculation on Attachment 4, page
8 13 of 46, to DPS-52 (DAG-5), the Company
9 discovered that the allocation percentages were
10 incorrect and therefore did not update the Rate
11 Year forecast using these percentages."

12 Q. Is the Company now proposing to reflect revised
13 allocation percentages for the projected rate
14 year Reservoir Woods costs allocated to Niagara
15 Mohawk?

16 A. Yes, in its response to IR DPS-490 (GRL-32), the
17 Company includes an updated bill pool #00603
18 calculation based on an updated analysis of the
19 Reservoir Woods facility. The Company's updated
20 analysis reflects allocation percentages of
21 25.912% and 5.815% for Niagara Mohawk electric
22 and gas, respectively.

23 Q. Do you have any comments on the new Reservoir
24 Woods cost allocation analysis provided by the

1 Company in its response to IR DPS-490 (GRL-32)?

2 A. Yes, we find it very curious that suddenly the
3 Company now has a finalized updated analysis,
4 when only 11 days prior, in its July 30, 2012
5 response to IR DPS-443 (CAS-18), the Company
6 indicated that it had determined that the re-
7 organization needed to be complete before the
8 bill pool analysis could be updated, if
9 necessary. Also the Company stated, "To date,
10 the Company has not completed this analysis to
11 determine the allocation on a post restructuring
12 basis. As restructuring effected all
13 departments, the Company does not believe that
14 any change in the bill pool would be material."
15 Apparently the Company now believes the change
16 in the bill is material enough to warrant a
17 change in the projected rate year Reservoir
18 Woods to Niagara Mohawk.

19 Q. What is the adjustment the Company has
20 calculated?

21 A. The Company has applied the updated allocation
22 amounts, 25.912% and 5.815% for Niagara Mohawk
23 electric and gas, respectively, resulting from
24 its updated analysis. The Company applies these

1 allocation percentages to the total National
2 Grid Reservoir Woods costs projected to be
3 incurred in the rate year. This includes
4 \$17.756 million for rent expense and an
5 additional \$0.991 million for other expenses, as
6 shown in the Company's response to IR DPS-490
7 (GRL-32), Attachment 2. The Company then
8 applies the new updated allocation factors to
9 the gross National Grid amounts to determine the
10 newly revised Niagara Mohawk allocated amounts
11 for the projected rate year. The Company's new
12 calculation results in a reduction of \$1.144
13 million to electric expense and an increase to
14 gas expense of \$0.342 million.

15 Q. Do you agree with the Company's calculation?

16 A. Absolutely not. The Company's newly provided
17 "updated" analysis should be disregarded for two
18 reasons. First, the Company's response and
19 supporting analysis for IR DPS-490 (GRL-32) is
20 suspect. It was only after Staff asked about
21 the discrepancy between its responses to IRs
22 DPS-443 (CAS-18) and DPS-52 (DAG-5), that the
23 Company did anything about providing the updated
24 analysis that it had allegedly been working on.

1 If it was going to incorporate the updated
2 analysis into the rate case, and if it was so
3 close to completing the analysis, it should have
4 stated such 11 days earlier in the response to
5 IR DPS-443 (CAS-18). If we had not followed up
6 with IR DPS-490 (GRL-32), it is highly unlikely
7 the Company would have come forth with any
8 updated Reservoir Woods cost analysis.

9 Q. What is your second reason?

10 A. The Company states that in reviewing the fiscal
11 year 2013 billing pool #00603 calculation
12 supplied in the response to IR DPS-52 (DAG-5),
13 it discovered the allocation percentages were
14 incorrectly stated. This statement is highly
15 suspect too, and should be given no weight. IR
16 DPS-52 (DAG-5) asked for a copy of the Company's
17 accounting manual, any instructions that
18 accompanied it, billing pool information for the
19 historic test year, and any updates subsequent
20 to December 2011. The Company supplied the
21 billing pool allocators that are being used in
22 the fiscal year 2013 accounting process as part
23 of its response to IR DPS-52 (DAG-5). To state
24 now that at least one bill pool that is

1 currently used and relied upon in charging costs
2 to Niagara Mohawk is incorrect, calls not only
3 all currently used bill pool allocations into
4 question, but also begs the question to what
5 extent past and future bill pool allocation
6 calculations can be relied upon in projecting
7 rate year expenses allocated to Niagara Mohawk.

8 Q. Has the Company provided a supplemental response
9 to IR DPS-52 (DAG-5) that would indicate they
10 have updated the fiscal year 2013 billing pools
11 being used for accounting purposes?

12 A. No. No revised billing pool charts have been
13 provided.

14 Q. What is your recommendation for determining the
15 proper level of rate year Reservoir Woods costs
16 that should be allocated to Niagara Mohawk?

17 A. The Company should be held to the bill pool
18 #00603 allocations being used for fiscal year
19 2013 as presented on May 24, 2012 in its
20 response to IR DPS-52 (DAG-5). As stated
21 previously, the Company has identified the
22 fiscal year 2013 allocations to Niagara Mohawk
23 for the Reservoir Woods costs as 23.560% for
24 electric and 3.755% for gas. These are the

1 percentages Staff recommends be used in
2 determining the rate year expenses for Reservoir
3 Woods costs allocated to Niagara Mohawk.

4 Q. What is your adjustment?

5 A. We are using the Company's gross Reservoir Woods
6 amount for the rate year of \$18.747 million, as
7 shown on IR DPS-490 (GRL-32) Attachment 2, page
8 1. This amount should then be allocated 23.560%
9 to Niagara Mohawk electric, and 3.755% to
10 Niagara Mohawk gas, for an allowed rate year
11 amount of \$4.417 million and \$0.704 million,
12 respectively. This produces a total reduction
13 to the Company's rate year forecast of Reservoir
14 Woods costs of \$1.629 million (\$1.585 million
15 for electric; \$0.045 million for gas). We have
16 provided a calculation of our adjustments in
17 Staff's workpapers, Exhibit __ (SAP-4).

18 **2. Service Company Return on Assets**

19 Q. Please explain what is meant by the term
20 "service company return on assets."

21 A. At page 14 of the Service Company Panel
22 testimony, the Company states "The service
23 companies own or lease a number of shared assets
24 that are used either by service company

1 employees to provide services to affiliates or
2 are used by the affiliates on a shared basis."
3 Further, it stated "When the service companies
4 finance and own the shared assets, the service
5 companies charge the affiliates a rental fee
6 based on pre-tax return on asset." The
7 requested service company return on assets is
8 9.76%, with the calculation shown on Exhibit __
9 (SCP-8).

10 Q. Do you agree with the Company's calculated
11 service company return on assets rate of 9.76%?

12 A. No, not entirely. We have substituted Staff's
13 proposed capital structure and cost rates into
14 the Company formula, producing a return on
15 assets rate of 8.63%. In developing rate year
16 cost projections, we recommend this revised rate
17 be used in place of the Company's 9.76% rate.

18 Q. Which cost elements are affected by the service
19 company capital charges?

20 A. In response to IR DPS-483 (DAG-75), the Company
21 indicated the service company capital charges
22 affect the Reservoir Woods leasehold
23 improvements rent expense, and the capitalized
24 software and other information systems rent

1 expense. The service company base amount,
2 against which the service company return on
3 asset rate is applied, is provided in IR DPS-483
4 (DAG-75).

5 Q. Are you using the Company's provided service
6 company base amount in its return on asset
7 calculation?

8 A. No. We have adjusted the service company base
9 amount to take into account Staff's proposed
10 adjustment to billing pool #00603 allocation
11 percentages.

12 Q. What is your proposed adjustment?

13 A. We have applied our calculated return on asset
14 rate of 8.63% to the Staff adjusted service
15 company base amount to calculate the rental fee
16 amount Niagara Mohawk should be allowed to
17 recover. Staff's recommended adjustment is a
18 reduction to rate year rent expense of
19 \$1,850,000 (\$1,562,000 for electric; \$288,000
20 for gas).

21 **D. Materials - Outside Vendor**

22 Q. Please explain Staff's adjustment to the cost
23 element #M10 for materials for outside vendors.

24 A. This adjustment corrects for an error made in

1 the Company's Corrections & Updates filing for
2 postage expense. The Company reflected an
3 adjustment based on its response to IR DPS-327
4 (CAS-15), but the wrong adjustment amount was
5 incorporated. Staff's proposed adjustment
6 corrects for this error.

7 Q. Does the Company agree with this adjustment?

8 A. Yes. The Company's response to IR DPS-491 (DAG-
9 81) confirms an additional adjustment is
10 required. The materials outside vendor expense
11 projection for the rate year should be reduced
12 by an additional \$338,640 (\$281,071 for
13 electric; \$57,569 for gas).

14 **E. Labor**

15 **1. Percentage of Labor Capitalized**

16 Q. What percentage of labor costs did the Company
17 forecast would be capitalized in the rate year?

18 A. The Company forecast 36.0% of total Niagara
19 Mohawk labor costs would be capitalized in the
20 rate year.

21 Q. What was the basis for this estimate?

22 A. 36.0% was the actual percentage of labor
23 capitalized in the historic test year.

24 Q. Do you agree with this forecast?

1 A. No. In response to IR DPS-115 (RMD-12), the
2 Company supplied monthly and rolling 12 month
3 total updates of its actual labor costs split
4 between expense, capital and other. As shown on
5 that response, the percentage of Niagara Mohawk
6 labor costs capitalized for the twelve-months
7 ending July 31, 2012 is 38.1%, or 2.1 percentage
8 points higher than the percentage capitalized in
9 the historic test year.

10 Q. Generally speaking, what impact does
11 understating the forecasted percentage of rate
12 year labor capitalized have upon the revenue
13 requirement?

14 A. Understating the forecasted percentage of rate
15 year labor capitalized means that the forecasted
16 percentage of rate year labor expensed is
17 overstated. An overstated forecasted percentage
18 of rate year labor expensed means that the labor
19 expense forecast is overstated, which in turn
20 means the revenue requirement is overstated.

21 Q. What labor capitalization rate do you recommend
22 using to forecast rate year labor expense?

23 A. We recommend using the actual capitalization
24 rate for the twelve-months ended July 31, 2012

1 as this more recent data provides a better
2 estimate of rate year activity. As such, the
3 capitalization rate applied to labor costs would
4 be 38.1%, which would result in a decrease of
5 \$7,296,800 from the Company's rate year labor
6 expense forecast (\$6,056,300 for electric
7 expense; \$1,240,500 for gas expense).

8 Q. Does your adjustment to the labor capitalization
9 rate apply to all labor costs?

10 A. No. Our adjustment only affects labor costs
11 charged directly from Niagara Mohawk. It does
12 not include or affect labor costs charged from
13 National Grid Service Company, KeySpan Corporate
14 Services, KeySpan Utility Services, KeySpan
15 Engineering and Survey (Service Companies), or
16 any other affiliate.

17 Q. Did Staff propose a similar adjustment in
18 Niagara Mohawk's last electric rate case?

19 A. Yes. In Case 10-E-0050, the Staff Accounting
20 Panel utilized an updated labor capitalization
21 rate of 37.6% from March 2010 as opposed to the
22 historic test year September 2009 rate of 35.77%
23 used by the Company.

24 Q. Please summarize the Commission decision

1 regarding this adjustment.

2 A. The Commission rejected it stating, "The rate
3 year forecast of labor and benefits expense is
4 the product of both the forecasted total cost of
5 labor and the capitalization rate that allocates
6 the cost to expense. The Staff proposal
7 attempts to update this forecast only for the
8 higher fiscal year capitalization rate, thereby
9 reducing rate year expense, while ignoring that
10 the fiscal year total labor costs used to derive
11 the capitalization rate are higher than the
12 historic test year. Updating for only one
13 element of the forecast in this case results in
14 an improper understatement of the rate year
15 expense." The Commission however, noted,
16 "The Company agreed that Staff's proposal would
17 be acceptable if total labor did not increase
18 between the historic test year and the fiscal
19 year, and instead there was a shift of total
20 labor expense to capital in the latter year.
21 However, Niagara Mohawk asserts that this is not
22 the case here. It notes that total labor costs
23 increased by 10.8% between the end of the
24 historic test period and the fiscal year."

1 Q. Do you wish to clarify the Commission's
2 reference to a 10.8% increase in total labor
3 costs?

4 A. Yes. The 10.8% increase cited by the Company
5 and referenced by the Commission does not
6 represent the percent increase in total labor
7 costs, but rather is the sum of the percent
8 increases for each component of labor - expense,
9 capital and other (i.e. 2.2% + 7.0% + 1.6%).
10 Using the Company's numbers from that case, the
11 actual percent increase in total labor costs
12 during that time period was 3.3%.

13 Q. If the Commission rejected this type adjustment
14 before, why do you propose it here?

15 A. The Commission's concern in the last case was
16 that updating for only one element of the
17 forecast resulted in an improper understatement
18 of the rate year expense. The current
19 circumstances differ from the last case in that
20 Niagara Mohawk's total labor costs, rather than
21 increasing, are trending downward. Data relied
22 on in the last electric case provided that,
23 between September 2009 and March 2010, Niagara
24 Mohawk's total labor costs increased by 3.3%.

1 However, in the current case the facts and
2 circumstances are the opposite. Specifically,
3 between December 2011 and July 2012, Niagara
4 Mohawk's total labor costs have actually
5 decreased by 1.7%, with the largest decrease
6 occurring in labor expense (4.8%). We attribute
7 the implementation of its US Restructuring as
8 the main reason for the reduction in the
9 Company's labor costs. However, we note that
10 the labor costs for the twelve months ending
11 July 2012 do not include the full impact of the
12 workforce reductions associated with US
13 Restructuring. On a normalized basis, the labor
14 costs would be even lower. To show how our
15 adjustment is reasonable, we took the July 2012
16 level of labor expense, applied a growth rate to
17 capture the 2012 and 2013 salary increases, and
18 compared the result to the Company's rate year
19 forecast. The results clearly support our
20 adjustment.

21 Q. Please explain your analysis.

22 A. According to the Company's response to IR DPS-
23 115 (RMD-12), \$214.473 million is the amount of
24 Niagara Mohawk labor charged to expense for the

1 twelve months ending July 2012. We then applied
2 a 5% growth rate which approximates the
3 Company's salary increases between July 2012 and
4 the rate year. This is based on management pay
5 increases of 3.37% in July 2012 and 3.00% in
6 July 2013; and represented wage increases of
7 2.50% in April 2012 and 2013. Our calculation
8 resulted in a rate year labor expense forecast
9 of \$225.196 million.

10 Q. How does this compare to the Company's rate year
11 labor expense?

12 A. The \$225.196 million we calculated was \$8.621
13 million less than the Company's rate year
14 forecast of \$233.818 million as shown on Exhibit
15 __ (RRP-3CU), Schedule 31, Page 24.

16 Q. What do you conclude from this analysis?

17 A. The analysis clearly shows that Niagara Mohawk's
18 rate year labor expense forecast is overstated.

19 Q. How does the \$8.621 million difference compare
20 to your adjustment?

21 A. The \$8.621 million difference is higher than our
22 \$7.297 million adjustment, which shows that our
23 adjustment is conservative in nature.

24 Q. Does the Company's CAPEX budget for the rate

1 year support your adjustment to use a higher
2 percentage of labor allocated to capital?

3 A. Yes. According to Exhibit ____ (RRP-7) Schedule
4 1, Page 7, CAPEX spending for the rate year is
5 forecasted to be approximately 20% higher than
6 the historic test year level.

7 Q. Does your adjustment require that the amount of
8 capitalized labor be increased by \$7,296,800?

9 A. No. According to the Company's response to IR
10 DPS-155 (RMD-14) Part B, "The incremental
11 capital costs associated with the increase in
12 Rate Year 2014 capital spending are comprised of
13 both labor and non-labor components and are
14 fully reflected in the Company's Rate Year
15 capital expenditure forecast in RRP-7, Schedule
16 1. The Company forecasts labor costs for
17 purposes of determining rate year labor expense
18 (included in RRP-3, Schedule 31) independent of
19 the capital expenditure forecast, and based on
20 staffing levels at the end of the HTY, December
21 31, 2011." Since, as the Company acknowledges
22 the labor forecast and the capital expenditure
23 forecast were developed independently, no rate
24 base adjustment is necessary.

1 **2. Percentage of Variable Pay Capitalized**

2 Q. Please explain how the Company allocated
3 variable pay between expense and capital for the
4 rate year.

5 A. According to the response to IR DPS-320 (RMD-
6 29), the Company allocated 100% of variable pay
7 that was charged from Niagara Mohawk to expense.
8 However, variable pay charged from the Service
9 Companies was allocated between expense and
10 capital in the same manner as productive payroll
11 is charged.

12 Q. Did you ask the Company to explain why the
13 disparity in allocation of variable pay?

14 A. Yes. According to the Company's response to IR
15 DPS-320 (RMD-29), its proposal follows its
16 current accounting practice. However, the
17 Company also stated that allocation between
18 expense and capital in the same percentage as
19 productive payroll for Niagara Mohawk variable
20 pay would be reasonable.

21 Q. What capitalization rate do you recommend using
22 to forecast Niagara Mohawk's variable pay for
23 the rate year?

24 A. We recommend using the same rate that was

1 applied to productive pay, updated for the
2 actual capitalization rate for the twelve-months
3 ended July 31, 2012. As such, the labor
4 capitalization rate would be 38.1%, which would
5 result in a rate year variable pay expense
6 forecast of \$16,459,900, or a decrease of
7 \$4,137,600 from the Company's forecast
8 (\$3,434,200 for electric expense; \$703,400 for
9 gas expense). The Company provided
10 quantification for this adjustment in response
11 to IR DPS-438 (RMD-35) Attachment 2.

12 Q. In the past, the Commission has rejected
13 variable pay allowances. Does this adjustment
14 apply if the Commission disallows some or all of
15 the variable pay?

16 A. No. If the Commission disallows a portion or
17 all of the variable pay, Staff recommends that
18 the Company's existing accounting practice be
19 modified to expense 100% of Niagara Mohawk
20 variable pay portion excluded from rates and a
21 38.1% labor capitalization rate be applied to
22 the portion included in rates.

23 Q. Please clarify whether you are testifying to the
24 reasonableness of the Company's rate year

1 variable pay forecast and whether the costs
2 should be reflected in rates.

3 A. No. Staff witness Schuler addresses both of
4 these issues in his testimony. Our testimony
5 only addresses how the Company's variable pay is
6 allocated between expense and capital.

7 **3. Management Compensation Adjustments**

8 Q. Please summarize the management compensation
9 adjustments to the rate year.

10 A. Staff witness Schuler is proposing two specific
11 management compensation adjustments. His first
12 adjustment limits management pay increases to
13 2.90% per year as opposed to 3.37% for 2012 and
14 3.0% thereafter, as requested by the Company.
15 This adjustment results in a \$565,900 reduction
16 to management compensation which when applied to
17 the Company's management pay expense factor of
18 76.6%, as shown on the Company's response to IR
19 DPS-438 (RMD-35), results in a \$433,700
20 reduction to rate year labor expense (\$360,000
21 for electric expense; \$73,700 for gas expense).
22 His second adjustment reflects the pay
23 differential by regions, resulting in a
24 \$2,712,400 reduction to management compensation

1 which, when applied to the same 76.6% expense
2 factor, results in a \$2,078,600 reduction to
3 rate year labor expense (\$1,725,200 for electric
4 expense; \$353,400 for gas expense). In total,
5 Staff witness Schuler is recommending a
6 \$3,278,300 reduction to the Company's rate year
7 management compensation which, when applied to
8 the Company's management pay expense factor of
9 76.6%, results in a \$2,512,300 reduction to the
10 Company's rate year labor expense forecast
11 (\$2,085,200 for electric expense; \$427,100 for
12 gas expense). We will later address the
13 specific management compensation costs
14 identified by Staff witness Schuler and the
15 operation of these costs within the concept and
16 structure of the Service Level Agreements with
17 its affiliates.

18 **4. Other Labor Adjustments**

19 Q. Are you proposing any other adjustments to
20 labor?

21 A. Yes. As noted in the Company's response to IR
22 DPS-395 (DAG-50), the Company's rate year labor
23 should be reduced by \$49,300 to reflect the
24 removal of one additional full-time equivalent

1 employee associated with US Restructuring
2 (\$41,300 for electric expense; \$8,000 for gas
3 expense).

4 Q. Please continue.

5 A. We also reflected a \$411,700 reduction to
6 electric labor expense as proposed by the Staff
7 Electric Infrastructure Panel.

8 Q. Please summarize the total impact of Staff's
9 labor adjustments.

10 A. Staff is proposing to reduce the Company's rate
11 year labor forecast of \$280,174,500 by
12 \$14,407,700, resulting in a rate year forecast
13 of \$265,766,800 (\$223,483,200 for electric
14 expense; \$42,283,600 for gas expense).

15 **F. Fringe Benefits**

16 **1. Percentage of Employee Benefits**
17 **Capitalized**

18 Q. What percentage of employee benefit costs did
19 the Company forecast would be capitalized in the
20 rate year?

21 A. The Company forecast 38.66% of total Niagara
22 Mohawk employee benefit costs would be
23 capitalized in the rate year.

24 Q. What was the basis for this estimate?

1 A. 38.66% was the actual percentage of employee
2 benefit costs capitalized in the historic test
3 year.

4 Q. Is the fringe benefit capitalization rate the
5 same as the labor capitalization rate?

6 A. In theory it should be, as fringe benefits
7 should follow the same allocation as labor
8 costs. However, when computing the
9 capitalization factor for fringe benefits,
10 differences can arise because the Company
11 includes only the labor cost components that
12 contribute to net productive labor. For
13 example, the Company does not include the labor
14 components P21 - represented incremental
15 overtime, P26 - management incremental overtime,
16 and time not worked, in its determination of net
17 productive labor. Conversely, when computing
18 the capitalization rate for labor costs, all
19 components of labor are included. For example,
20 in the Company's response to IR DPS-115 (RMD-12)
21 the labor capitalization rate for the historic
22 test year is 36.0%. This compares to the
23 Company's calculated fringe benefit
24 capitalization rate of 38.66% for the same time

1 period, as shown in the Company's response to IR
2 DPS-160 (AAE-5).

3 Q. Do you agree with using the Company's 38.66%
4 allocation rate for determining the rate year
5 forecast of capitalized fringe benefits?

6 A. No, we recommend using a more current
7 capitalization factor in place of the 38.66%
8 rate.

9 Q. Please explain why.

10 A. In response to IR DPS-160 (AAE-5), the Company
11 supplied monthly and rolling 12 month total
12 updates of its actual employee benefit
13 capitalization rate. As shown, the percentage
14 of Niagara Mohawk employee benefit costs
15 allocated to capital and other has increased
16 subsequent to the historic test year ending
17 December 2011 time period.

18 Q. What specific time period are you using to
19 determine the forecasted rate year fringe
20 benefit capitalization rate?

21 A. Similar to our recommendation for updating the
22 labor capitalization rate, we recommend using
23 the actual capitalization rate for the twelve-
24 months ended July 31, 2012 as this more recent

1 data provides a better estimate of rate year
2 activity. As such, the employee capitalization
3 rate should be 40.78%.

4 Q. In addition to following the increase in the
5 labor capitalization rate, is there any other
6 support for using a higher percentage of fringe
7 benefits allocated to capital?

8 A. Yes. According to Exhibit ____ (RRP-7) Schedule
9 1, Page 7, CAPEX spending for the rate year is
10 forecasted to be approximately 20% higher than
11 the historic test year level.

12 Q. What specific accounts are impacted by this
13 change?

14 A. A change to the employee capitalization rate
15 impacts the following accounts: health care,
16 workers compensation, thrift plan, FAS 112 post-
17 employment, group life insurance, pensions and
18 OPEBs.

19 Q. What is the rate year adjustment needed to
20 reflect an employee benefit capitalization rate
21 of 40.78% to each of the impacted accounts?

22 A. We are reflecting the following adjustments: (1)
23 reduction to health care expense of \$709,000
24 (\$588,500 for electric expense; \$120,500 for gas

1 expense); (2) reduction to worker's compensation
2 expense of \$128,700 (\$106,800 for electric
3 expense; \$21,900 for gas expense); (3) increase
4 to thrift plan expense of \$96,300 (\$79,900 for
5 electric expense; \$16,400 for gas expense); (4)
6 reduction to FAS 112 long term disability
7 expense of \$154,400 (\$128,200 for electric
8 expense; \$26,200 for gas expense); (5) reduction
9 to group life insurance expense of \$47,000
10 (\$39,000 for electric expense; \$8,000 for gas
11 expense); (6) reduction to pension expense of
12 \$1,439,300 (\$1,194,600 for electric expense;
13 \$244,700 for gas expense); and (7) reduction to
14 OPEBs expense of \$1,405,000 (\$1,166,200 for
15 electric expense; \$238,900 for gas expense).

16 **2. Other Fringe Benefits Adjustments**

17 Q. Are you proposing any other adjustments to
18 health care?

19 A. Yes. As noted in the Company's response to IR
20 DPS-395 (DAG-50), the Company's rate year
21 employee benefits forecast should be reduced by
22 \$7,200 to reflect the removal of one additional
23 full-time equivalent employee associated with US
24 Restructuring (\$5,900 for electric expense;

1 \$1,300 for gas expense).

2 **G. Productivity**

3 Q. Does the Company's rate year forecast of
4 productivity need to be adjusted for your
5 proposed labor and payroll tax adjustments?

6 A. Yes. A concomitant adjustment needs to be made
7 to follow our labor and payroll tax adjustments
8 because productivity is calculated on the sum of
9 labor and payroll taxes. As a result, a
10 reduction to the Company's forecasted rate year
11 productivity of \$345,400 is required (\$288,400
12 for electric expense; \$57,000 for gas expense).
13 We have provided the calculation in our
14 workpapers contained in Exhibit __ (SAP-4).

15 Q. Are you proposing any other adjustments to
16 productivity?

17 A. Yes. As noted in the Company's response to IR
18 DPS-395 (DAG-50), the Company's rate year
19 productivity forecast should be reduced by an
20 additional \$1,200 to reflect the removal of one
21 additional full-time equivalent employee
22 associated with US Restructuring.

23 **H. Uncollectible Accounts**

24 Q. What is the Company's forecast for

1 uncollectible, or UCBs, expense in this
2 proceeding for the rate year?

3 A. The Company has included a forecast of \$35.595
4 million for electric UCBs expense and \$17.668
5 million for gas UCBs expense, a total of \$53.263
6 million.

7 Q. Please explain the Company's methodology for its
8 calculation of \$53.263 million in uncollectible
9 expense.

10 A. The Company's proposed uncollectible expense
11 method is to divide historic twelve months of
12 net write-offs by twelve months of revenues to
13 arrive at an uncollectible percentage. The
14 uncollectible percentage is then multiplied
15 against rate year revenues to arrive at a rate
16 year uncollectible expense. The assumption or
17 theory behind this calculation is that, for
18 ratemaking purposes, a percentage of the rate
19 year revenues will not be collected and this
20 expense attempts to measure this non-collection.
21 In this case, the Company proposes to update to
22 the latest 12 months of actual net write-offs
23 and revenues information that is available, to
24 calculate a percentage and apply it to the rate

1 year revenues. The Company's methodology and
2 use of the latest available twelve months
3 information has been adopted by the Commission
4 in the previous electric rate case. In the last
5 gas rate case, a settlement was reached that
6 resulted in the use of historic and latest
7 current information.

8 Q. Do you agree with the Company's method and
9 update proposal in this case?

10 A. We agree with the Company's method of dividing
11 twelve months of net write-offs by revenues to
12 arrive at a percentage and multiply it against
13 rate year revenues. However, we do not agree
14 with the use of only the latest information for
15 the calculation of the percentage.

16 Q. Please explain.

17 A. As provided in the Company's responses to IR
18 DPS-13(GRW-1) and IR DPS-472(GRW-26), the net
19 write-off for the latest twelve months ended
20 June 2012 is \$67.5 million, \$46.9 million for
21 electric and \$20.6 million for gas. This level
22 is \$7.3 million higher than the average net
23 write-offs made for the similar periods 2008
24 through 2012. Furthermore, the amount of \$67.5

1 million approaches levels not seen since 2009, a
2 period of extreme economic distress. Lastly, the
3 UCB rate for May and June 2012 is at a five year
4 historic high. Exhibit__ (SAP-4) includes a
5 workpaper that shows the historic information
6 and calculations of the UCB rates. These high
7 rates are at a time when current revenues are at
8 a historic low. The Company offers two reasons
9 for the high level of write-offs during the
10 first half of 2012. The first reason, as cited
11 in the response to IR DPS-370 (GRW-20), is due
12 to the impacts of the relatively hot summer of
13 2010 followed by the colder winter of 2010 -
14 2011. With the 90-day lag between termination
15 and write-off, the write-offs carried over into
16 the write-off season of 2011.

17 Q. What is the second reason?

18 A. As stated in the direct testimony of Shared
19 Services and Customer Panel (SSCP) at pages 26-
20 27, the manual phase of the Transfer-to-Active
21 Project, or TAP, caused uncollectible rates to
22 be generally higher in 2011, especially when
23 looking at the twelve month rolling rate.

24 Q. What is TAP?

1 A. As explained by the SSCP testimony at pages 22-
2 24, during 2010 and through early 2011, the
3 Company undertook a project to reinstate
4 previously written-off accounts and transfer the
5 unpaid balances to active. This project, the
6 TAP, included an automated system change to the
7 account initiation process that matches
8 customers seeking new service with previously
9 written-off amounts in the customer's name.
10 This is performed via a database search using a
11 credit report service. The TAP also included a
12 one-time manual effort to transfer previously
13 written-off balances up to five years old to
14 active accounts. The manual phase resulted in a
15 one-time \$9 million shift from the uncollectible
16 reserve to active, which reduced uncollectible
17 write-offs in the near term as previously
18 written-off amounts were reinstated to active
19 accounts, and, as a result, favorably affected
20 uncollectible rates. Over time, any unrecovered
21 balances associated with these reinstatements
22 will move to write-off again, thereby increasing
23 the write-offs in the future or during the
24 period the Company will update the UCB rate.

1 Q. What was the impact to Niagara Mohawk of the
2 reinstated accounts receivable during 2010 and
3 through early 2011 during the TAP program?

4 A. According to the SCCP testimony at page 23,
5 during the period of the TAP program, the
6 Company reinstated accounts balances grew from
7 \$22 million to over \$57 million. For the prior
8 period, 2003 through 2010, the reinstated
9 balances were in the \$19 million range. These
10 balances are now eligible to be written-off
11 again for non-payment. Therefore, future write-
12 offs will not only include current bills, but
13 there is a potential for write-offs of an
14 additional \$35 million, the difference computed
15 by deducting the \$22 million from the \$57
16 million.

17 Q. How does this potential \$35 million impact the
18 update for uncollectible expense?

19 A. It increases the net write-offs in the rolling
20 twelve month time period used to calculate the
21 uncollectible percentage factor in this case.
22 The customer bills not only include current bill
23 charges but bill charges that go back five
24 years. The Company admits as much in its SSCP

1 testimony at page 26; that write-offs will be
2 higher where any unrecovered balances associated
3 with these reinstatements will move to write-
4 offs thereby increasing the uncollectible rates.

5 Q. How will the end of the transfer to active
6 accounts under the TAP program impact UCBs?

7 A. The Company anticipated that the uncollectible
8 rate would rise in the first six months of 2012,
9 partially as a result of the increasing net
10 write-offs from the TAP program. Since the
11 benefits of TAP concluded in February 2011, the
12 rolling net write-offs will increase for every
13 month after February 2011 and will be completely
14 eliminated from net write-offs for rolling 12
15 month periods after February 2012. During TAP,
16 recoveries were higher than normal as result of
17 the balance transfers from the uncollectible
18 reserve to active accounts. The higher
19 recoveries reduced gross write-offs so net
20 write-offs were lower than they would be without
21 TAP.

22 Q. Does the Company address the level of net write-
23 offs through the end of 2012?

- 1 A. No, the Company does not address where net
2 write-offs will be at the end of the year; the
3 period they chose for the update of the UCB
4 rate. The responses to DPS-370 (GRW-20) and
5 DPS-386 (GRW-22) show gross write-offs at May
6 2012, for both electric and gas, at the highest
7 level in years. In its response to IR DPS-370
8 (GRW-20), the Company, however, does indicate
9 that there could be a more favorable level of
10 write-offs largely driven by the significant
11 lower bills from this past winter.
- 12 Q. Please explain why it is not proper to use the
13 latest known information.
- 14 A. As explained, the purpose of any uncollectible
15 expense is to provide recovery of rate year
16 revenues that are not collected in the rate
17 year. The use of the Company's update based on
18 the latest available 12 months data doesn't
19 appear to be reasonable, especially in light of
20 the UCB rates for the May 2012 and June 2012
21 periods. The UCB rates are abnormally high when
22 compared to historic three year and five year
23 UCB rates as shown in our workpapers included in
24 Exhibit__ (SAP-4). According to the Company,

1 there is no reason to believe that UCB rates
2 will fall to more normal levels. But the
3 Company never addresses why these abnormal UCB
4 rates are reasonable. The Company never
5 addresses why write-offs will not fall for all
6 of 2012, especially in light of lower customer
7 bills due to lower commodity costs and normal
8 weather. Nor does the Company address why lower
9 customer bills will make it easier for customers
10 to pay their bills and reduce the number of
11 write-offs.

12 Q. How do you propose to calculate uncollectible
13 expense?

14 A. Uncollectible expense should provide an
15 allowance to offset the portion of rate year
16 revenues that will not be collected. Our
17 adjustment uses the Company method to calculate
18 the uncollectible expense with one change.
19 Rather than using the latest twelve months of
20 write-offs, we propose to use the latest
21 available 3 year Aggregated Uncollectible Rate
22 as shown on the response to DPS-13(GRW-1),
23 Attachments 1 (Electric) and 2 (Gas). The
24 aggregated method is calculated by taking the

1 sum of three years net write-offs and dividing
2 it by the sum of three years of revenues for a
3 similar period. It approximates the result from
4 taking three uncollectible rates and dividing by
5 three.

6 Q. Why is the use of the three year Aggregated
7 Uncollectible Rate necessary?

8 A. The current 2012 UCBs are abnormal and need to
9 be normalized to exclude the impacts of the
10 relatively hot summer of 2010 followed by the
11 colder winter of 2010 - 2011 and also to reflect
12 the impacts of TAP. The three year Aggregated
13 Uncollectible Rate period not only includes the
14 TAP benefits for the reinstatement of customer
15 balances and the lower net write-offs, but also
16 includes the higher level of write-offs due to
17 TAP. Lastly, this rate also includes the
18 abnormal level of write-offs for the abnormal
19 weather conditions.

20 Q. What adjustment are you proposing to
21 uncollectible expense?

22 A. Based on using the three year Aggregated
23 Uncollectible Rate, we are proposing to reduce
24 the Company's Corrections and Updates

1 uncollectible expense request from \$53.262
2 million to \$41.308 million for a total reduction
3 of \$11.954 million; an electric expense
4 reduction of \$7.115 million and a gas expense
5 reduction of \$4.839 million.

6 Q. How are the electric and gas expense adjustments
7 computed?

8 A. We have taken the latest three year Aggregated
9 Uncollectible Rate rates, as shown for electric
10 on DPS-13(GRW-1), Attachment 1 and for gas on
11 Attachment 2, and multiplied them by the Company
12 revenues that were provided in the Corrections &
13 Updates filing for uncollectible expense. We
14 have further adjusted the electric
15 uncollectibles expense for Staff's recommended
16 increase in electric operating revenues.

17 **I. US Restructuring Savings**

18 Q. Please explain the Company's US Restructuring
19 Program savings.

20 A. The US Restructuring Program is comprised of
21 both labor and non-labor savings. Throughout
22 the historic year, and up to the beginning of
23 the rate year, National Grid will have
24 eliminated over 1400 positions. The expected

1 labor savings from the US Restructuring Program
2 are reflected in the rate year forecast of the
3 labor expense component.

4 Q. How are the US Restructuring Program non-labor
5 savings reflected?

6 A. Based on its Corrections & Updates filing,
7 National Grid estimates it will achieve
8 approximately \$68.996 million of annual non-
9 labor savings by March 31, 2013. Niagara
10 Mohawk's allocated share of the non-labor
11 savings is \$20.925 million (\$17.618 million
12 electric; \$3.307 million gas). Of the \$20.925
13 million allocable to Niagara Mohawk, it is
14 estimated that \$7.220 million (\$6.186 million
15 electric; \$1.034 million gas) of non-labor
16 savings have been achieved and reflected in the
17 actual historic test year costs. Thus, these
18 savings are inherent in the rate year forecast,
19 as the historic test year is used as a base for
20 developing the projected rate year. The
21 remaining \$13.704 million (\$11.432 million
22 electric; \$2.273 million gas) of non-labor
23 savings, increased for inflation of 4.2785%, is
24 reflected as a credit on the income statement in

1 the line item entitled, "US Restructuring
2 Savings."

3 Q. Do you agree with the Company's projection?

4 A. No, not entirely. The Company has acknowledged,
5 in its response to IR DPS-392 (DAG-49), that
6 three adjustments need to be made for the
7 initiatives labeled as LEG14-LEG20, R&P1 and
8 NS25, as the savings achieved in both the
9 historic year and expected to be achieved in the
10 rate year were not correctly calculated. We are
11 reflecting these adjustments in Staff's revenue
12 requirement. The Company has calculated the
13 adjustments as an increase to expected rate year
14 US Restructuring savings, of \$518,291 (\$422,184
15 electric; \$96,107 gas).

16 Q. Do you agree with the Company's calculations?

17 A. No, the Company needs to increase the
18 adjustments for the inflation impact from the
19 historic year to the rate year, as all US
20 Restructuring program savings were calculated in
21 2011 dollars. Applying the Company's inflation
22 factor of 4.2785% to the base adjustment brings
23 the total US Restructuring savings adjustment to
24 \$540,466 (\$440,247 electric; \$100,219 gas).

1 **J. E&Y Analysis**

2 Q. Please explain the Company's review of the
3 historic test year service company costs.

4 A. As explained in pages 29 through 41 of the
5 Service Company Panel testimony, the Company
6 hired Ernst & Young, E&Y, to review the
7 accounting for costs charged from the service
8 companies to Niagara Mohawk during the historic
9 test year. E&Y reviewed O&M charges from
10 accounts payable, payroll expense, employee
11 expenses and general ledger journal entries to
12 determine (1) if the charges were incurred in
13 the historic test year; (2) if the charges were
14 made to the appropriate companies and segments;
15 (3) if allocated, if the appropriate bill pool
16 was used; and (4) if the charges should have
17 been below the line for ratemaking purposes.

18 Q. Did the Company make an adjustment to the
19 historic test year charges based on E&Y's
20 analysis?

21 A. Yes. The Company adjusted its rate year O&M
22 expenses by \$2.420 million and (\$.673) million
23 for electric and gas, respectively.

24 Q. Do you agree with the Company's adjustment?

1 A. No. As discussed by Staff Witness Schuler, E&Y
2 has not shown that the study is reasonably
3 representative, unbiased or statistically valid.

4 Q. Why does E&Y feel their findings are valid?

5 A. It appears that E&Y believes that since they
6 sampled a majority of the population of charges
7 (\$1.023 billion out of \$1.621 billion or 63%),
8 their findings are valid.

9 Q. Why is this incorrect?

10 A. Although E&Y states that they sampled \$1.023
11 billion of transactions, in fact they only
12 tested a fraction of that amount. There are a
13 number of examples where E&Y only looked at a
14 small portion of costs for a particular vendor,
15 but included all of the charges as "sampled"
16 charges. Thus, E&Y actually reviewed much less
17 than \$1.023 billion out of \$1.621 billion.

18 Q. Can you provide examples of this?

19 A. Yes. Workbook C1.184, for A F Supply shows
20 \$3.357 million of charges. However, E&Y states
21 "Gas conversions, so low risk, we test one, we
22 double check a sample and conclude these are
23 ok." Thus, E&Y tested four items for \$7,129 but
24 mischaracterized that all \$3.357 million were

1 included in the "sampled" amount.

2 Q. Can you provide another example?

3 A. Workbook C1.013 for HSBC provides the testing
4 procedures for the Company's purchasing card or
5 PCard transactions. E&Y looked at the
6 allocation of \$1.043 million of charges, but
7 erroneously indicated that all \$8.202 million
8 were included in the "sample" that was tested.

9 Q. Please provide another example.

10 A. Workbook C1.182 for Blackman, Inc. shows \$3.408
11 million of charges during the historic test
12 year. However, E&Y states, "EY used a sample
13 approach to test invoices from Blackman, testing
14 one invoice from each allocation code this
15 vendor charged." Therefore, E&Y tested 16 items
16 totaling \$3,943 but incorrectly characterized
17 all \$3.408 million as being included in the
18 "sampled" amount.

19 Q. Please provide another example.

20 A. Workbook C1.178 for FW Webb shows \$4.635 million
21 of charges during the historic test year.
22 However, E&Y states, "E&Y will test 1 sample
23 invoice for each of the six different direct
24 charges being utilized (All non-NIMO)."

1 Therefore, E&Y tested 6 items totaling \$20,085,
2 but incorrectly stated that all \$4.635 million
3 were included in the "sample".

4 Q. Please provide another example.

5 A. Workbook C1.047 for Stuart C Irby Company shows
6 \$1.306 million of charges. E&Y tested \$499,546
7 of charges, but incorrectly indicated that all
8 \$1.306 million were included in the "sample".

9 Q. Are there other examples?

10 A. Yes. Workbook C1.001 for DSM Energy Federation
11 shows that E&Y reviewed the allocation for 56.8%
12 of payables, Workbook C1.008 For Action Inc
13 states that E&Y reviewed the allocation for 21%
14 of payables and Workbook C1.010 for Conservation
15 Services Group shows it tested 59 of the 301
16 invoices, which represented 21% of the 2011
17 payable amount. However, for each of these
18 vendors, E&Y incorrectly indicated that the
19 total payable amount was included in the
20 "sample" that was tested. There are a number of
21 other such examples.

22 Q. Was the examination E&Y performed on this small
23 number of items sufficient?

24 A. No. In many instances, E&Y did not test in a

1 way which would allow them to accurately
2 determine if the costs were incurred in the
3 historic test year, if they were allocated to
4 the proper segment and/or company, or if they
5 were appropriately included above the line.

6 Q. Please provide an example.

7 A. With the 25 PCard transactions from HSBC
8 previously discussed, E&Y compared the
9 employee's payroll allocation with the PCard
10 expense allocation for each line item. If the
11 allocations matched, E&Y determined that the
12 expenses were appropriately allocated. However,
13 E&Y never looked at the receipts associated with
14 these items, therefore, they have no way to
15 determine what the costs were really for. As
16 such, they have no way to determine if the costs
17 were actually allocated correctly, much less if
18 they were incurred in the historic test year or
19 if they were appropriately included above the
20 line. Furthermore, the summary tab of the HSBC
21 workbook shows that for 3 of the 25 line items
22 selected, E&Y was unable to tie the amount back
23 to the individual vouchers. Instead of
24 considering these errors or unsupported costs,

1 E&Y simply picked 3 new items, stating that "As
2 we tested 100% of the voucher totals in Test #1,
3 we re-selected 3 new samples to perform payroll
4 testing."

5 Q. Can you provide another example of E&Y using
6 insufficient examination?

7 A. Yes. Workbook C1.004 shows \$9,605,345 of
8 charges from Pro Unlimited - a staffing company
9 which includes former Company employees who do
10 contract work for the Company. In the workbook,
11 E&Y states that they were unable to obtain
12 invoices or timesheets for these charges. As an
13 alternate procedure, E&Y compared the bill pool
14 used by the contractors with the bill pool used
15 by their managers. If the bill pools matched,
16 E&Y considered the costs to be appropriately
17 allocated. Again, without looking at source
18 documentation, in this case time sheets or
19 invoices, E&Y has no way to determine if the
20 costs were allocated correctly or if they were
21 incurred in the historic test year. E&Y's
22 alternate procedure does not provide for an
23 adequate examination of these charges.

24 Q. Were there other problems with the Pro Unlimited

1 testing procedures?

2 A. Yes. In IR DPS-448 (DAG-61), we asked the
3 Company to provide supporting documentation for
4 three line items we randomly selected. The
5 documentation provided shows that for two of the
6 three line items (#20 and #132), the work was
7 performed in December 2010, prior to the
8 historic test year and, as such, should have
9 been normalized out. However, E&Y's workbook
10 states that these costs were incurred in the
11 historic test year.

12 Q. Are you proposing an adjustment to normalize
13 these costs out of the historic test year?

14 A. No. Due to the low amount of these invoices,
15 \$45 and \$930 respectively, such an adjustment
16 would be immaterial. However, the fact that we
17 found errors in two out of the three items that
18 we looked at raises serious concerns about the
19 validity and accuracy of the limited work E&Y
20 was supposed to have done.

21 Q. How much of the \$515 million of accounts payable
22 charges E&Y claims to have sampled did they
23 actually examine?

24 A. We don't know.

1 Q. Why not?

2 A. In IR DPS-509 (DAG-89), we asked the Company to
3 provide the line items and charges that were
4 actually subject to examination. This
5 information would help us to determine how much
6 of the historic test year charges E&Y actually
7 sampled and tested. However, the Company did
8 not provide this information in the response,
9 but rather referred back to the workpapers in
10 E&Y's report.

11 Q. You have thus far discussed E&Y's testing of
12 accounts payable transactions. Do you have
13 similar issues with their testing of payroll
14 expenses?

15 A. Yes. For payroll testing, E&Y judgmentally
16 selected a sample of departments, and from
17 within that sample selected a sample of cost
18 centers. From within that sample of cost
19 centers, they judgmentally selected a sample of
20 employees. However, despite only looking at
21 this very small amount of individuals, E&Y
22 included all charges within the departments in
23 the "sample". Furthermore, it does not appear
24 that E&Y even looked at timesheets for the

1 employees it did select. As a result, their
2 assertion that any of these charges are
3 accurately allocated or appropriately charged is
4 not supportable.

5 Q. Do you have a similar issue with E&Y's testing
6 of employee expenses?

7 A. Yes. E&Y used a variety of sampling techniques
8 to test a small portion the \$14 million
9 population of employee expenses, however they
10 characterized all \$14 million as being included
11 in the "sample". Again, it is simply untrue
12 that E&Y examined all \$14 million of charges.

13 Q. Are there other problems with E&Y's analysis?

14 A. Yes. E&Y's analysis only looked at O&M
15 expenses; they made no examination of capital
16 related charges. Per the Company's 2011 FERC
17 Form 60 report, total Service Company billings
18 to affiliates were \$2.743 billion, however E&Y's
19 population only covered \$1.621 billion of
20 charges. By excluding 40% of the total charges
21 from the testing population, the validity and
22 completeness of the analysis is further
23 compromised.

24 Q. Are you proposing an adjustment related to this

1 analysis of historic test year charges?

2 A. Yes. For the reasons stated, we have little
3 confidence in E&Y's study. As such, we are
4 removing the O&M costs resulting from their
5 analysis.

6 Q. What is your adjustment?

7 A. As previously stated, the Company increased its
8 electric O&M expenses by \$2.420 million and
9 decreased its gas O&M expenses by \$.673 million
10 based on the results of this analysis. Our
11 adjustment to remove these costs will therefore
12 decrease rate year electric expense by \$2.420
13 million and increase rate year gas expense by
14 \$.673 million.

15 **K. Expatriate Proxy**

16 Q. Please explain what expatriate costs are.

17 A. As explained by the Company in response to IR
18 DPS-149 (DAG-22), an expatriate, or Expat,
19 employee is an employee who undertakes a short-
20 term (less than five years) international
21 assignment to live and work in another country.
22 In this case, an employee of National Grid plc,
23 would be working on assignment in the US, and
24 the costs associated with the assignment would

1 include salaries and benefits, a cost of living
2 allowance, relocation expenses, housing
3 allowance and other items.

4 Q. What is the Company's forecast for Expat costs
5 in the rate year ending March 31, 2014?

6 A. The Company's rate year forecast begins with
7 actual historic test year costs of \$2,124,399
8 (\$1,870,372 electric; \$254,027 gas), which is
9 then adjusted by \$90,892 (\$80,024 electric;
10 \$10,869 gas) to reflect inflation of 4.2785% for
11 the period between the historic test year and
12 the rate year; with a final credit adjustment in
13 the amount of \$549,400 (-\$457,700 electric; -
14 \$91,700 gas) for the Market Reference Point
15 (MRP) calculation. The Company's rate year
16 forecast for Expat costs, as of the Corrections
17 & Updates filing, is a total amount of
18 \$1,665,891 (\$1,492,696 electric; \$173,196 gas).

19 Q. Please explain what a Market Reference Point is.

20 A. In developing its rate year forecast, the
21 Company analyzed each position held by an Expat
22 during the historic test year and identified the
23 market-based level of cash compensation for the
24 position. The MRP adjustment reflects the

1 lesser of each Expat employee's actual cash
2 compensation, as adjusted for cost of benefits,
3 or compensation equal to a market determined
4 level for a US based employee in the Expat's
5 position, as adjusted for cost of benefits.

6 Q. Has the Company provided any further information
7 on Expat costs?

8 A. Yes, in IR DPS-382 (DAG-48), Staff requested
9 additional information on Expat costs as a
10 follow up to the Company's response to IR DPS-
11 149 (DAG-22). In its response, the Company
12 recognized that, in determining the proper level
13 of historic year costs to compare with the MRP,
14 it inadvertently failed to exclude three months
15 of UK billing for salaries and benefits. As a
16 result, the MRP calculation and adjustment that
17 is reflected in the C&U filing is not correct; a
18 further adjustment is warranted. The Company's
19 calculation in IR DPS-382 (DAG-48), as well as
20 the identification in its response to IR DPS-491
21 (DAG-81), shows that an additional adjustment
22 reducing its projected rate year Expat costs by
23 \$430,288 (\$398,865 for electric; \$31,423 for
24 gas) is needed.

1 Q. Do you agree with the Company's calculation of
2 this adjustment?

3 A. Yes.

4 Q. Are there any other adjustments that need to be
5 made in projecting rate year Expat costs?

6 A. Yes, there are two additional adjustments that
7 should be made. Through our analysis we found
8 there was a significant decrease in the number
9 of Expats who were charging costs to Niagara
10 Mohawk from throughout the historic test year
11 period to the first six months of 2012. The
12 Company explains in response to IR DPS-382 (DAG-
13 48) that twenty two Expats were on long term
14 assignment in the US for all or part of the
15 historic test year, with eleven of them ending
16 their assignments sometime during 2011. From
17 January 1, 2012 to June 30, 2012, an additional
18 five Expats have ended their assignments, and
19 another two are expected to leave their
20 assignment by the end of calendar year 2012.
21 Attachment 3 to the IR DPS-382 (DAG-48) response
22 indicates the additional remaining four Expats
23 currently on assignment have assignment end
24 dates of 1/31/13, 4/30/13, 12/31/13 and 2/28/14.

1 Attachment 3 clearly lays out the Company's
2 plans for the assignment end dates of current
3 Expats working in the US. Projected rate year
4 costs associated with Expats should be in sync
5 with the chart provided.

6 Q. Does the Company agree that any adjustment
7 should be made to reflect the decreasing number
8 of Expats on assignment?

9 A. In its response to IR DPS-382 (DAG-48), the
10 Company indicates it recognizes that to reflect
11 the decrease in Expats it should remove rate
12 year expense from the revenue requirement
13 associated with the Expats whose assignment
14 ended during the historic test year, as these
15 costs are supplemented by internal labor costs
16 already included in the revenue requirement.
17 The Company cites an amount of \$371,961
18 (\$343,351 electric; \$28,610 gas) as the
19 associated expenses included in the revenue
20 requirement for these Expats.

21 Q. Do you agree with this adjustment?

22 A. No. First, since the Company adjusted the
23 historic test costs by the inflation factor to
24 project rate year Expat expenses, 4.2785% for

1 inflation needs to be added to these amounts in
2 order to take out the appropriate level
3 currently reflected in the rate year. The
4 correct amount to reduce the rate year revenue
5 requirement is \$387,875 (\$358,041 for electric;
6 \$29,834 for gas). Second, while we agree the
7 adjustment cited by the Company should be made
8 as we just modified it, there also needs to be a
9 second adjustment.

10 Q. Please explain.

11 A. The Company's adjustment calculation only
12 removes Expats whose US assignment ended
13 throughout the historic test year. As already
14 discussed, there are seven additional Expats
15 whose assignments are ending by the end of
16 calendar year 2012. Even though it indicates in
17 its response to IR DPS-382 (DAG-48) that new
18 international assignments in the US were
19 suspended during this time frame due to the US
20 Restructure, the Company does not appear to
21 adjust the related costs for those Expats out of
22 the rate year revenue requirement.

23 Q. Will the Company replace the Expats that are
24 ending their assignments with any additional

1 complement of the internal workforce?

2 A. From the documentation the Company has provided,
3 it appears that is not the case. In its US
4 Restructuring savings initiative, the Company
5 has listed savings codes of HR111, FIN2, R&P3
6 and NS8, as being savings related to Expat
7 reductions. When questioned about these
8 particular savings in both IRs DPS-87 (DAG-7)
9 and DPS-382 (DAG-48), the Company provided
10 responses that indicated work responsibilities
11 for these Expats were either shifted to other
12 employees or the role was replaced with a US
13 employee. The Company has provided no
14 documentation or support showing they would hire
15 additional people, beyond what they are already
16 projecting and for which we are allowing, to
17 replace the Expats that are leaving. We see no
18 reason why the trend would be any different in
19 the future.

20 Q. What is Staff's recommended adjustment?

21 A. Based on the chart provided by the Company in
22 its response to IR DPS-382 (DAG-48), Attachment
23 3, the only Expat costs that should be allowed
24 in the rate year are for the Expats that are

1 shown to be on assignment in the rate year
2 period, and their projected rate year costs
3 should be prorated for the number of months in
4 the rate year they will be on assignment. There
5 are three Expats that are expected to be on
6 assignment during the rate year, assignee
7 numbers 100056346 for 9 months of the rate year,
8 100062327 for 1 month of the rate year, and
9 100062738 for 11 months of the rate year.
10 Staff's additional adjustment is to remove the
11 remaining Expats who will be ending their
12 assignments either before or during the rate
13 year, and results in a reduction of \$662,554
14 (\$577,668 for electric; \$84,886 for gas). This
15 adjustment is in addition to the amount
16 previously discussed, for a total adjustment to
17 Expat expenses included in the revenue
18 requirement of \$1,480,717. We have included a
19 workpaper with the calculations of Staff's
20 adjustment in Exhibit __ (SAP-4).
21 Q. Do you have any additional comments on the Expat
22 costs?
23 A. Yes, we think it is important to highlight that
24 this is another example of the Company not

1 adequately reviewing the historic test year
2 costs or projecting an accurate assessment of
3 the expected rate year costs. If it had done a
4 proper review initially, rather than performing
5 the analysis only as a result of a Staff IR, it
6 would have known what the actual historic test
7 year Expat costs were, and that there were costs
8 that needed to be removed before projecting the
9 rate year expense. As it is, it took two Staff
10 IRs - IRs DPS-149 (DAG-22) and DPS-382 (DAG-48)
11 pointing the Company in the right direction for
12 the Company to ascertain exactly the amount of
13 actual historic test year costs incurred. In
14 the future, the Company must do a better job of
15 reviewing and scrubbing the historic test year
16 in preparation of a major rate filing.

17 **L. Allocation Reclass**

18 Q. Please explain what is meant by allocation
19 reclassification?

20 A. The Company includes an "Allocation Reclass"
21 cost element on Exhibit __ (RRP-3CU) that shows
22 an adjustment to the historic test year based on
23 an analysis to derive the change in historic
24 test year costs which are the result of the

1 revisions to the general allocator and other
2 cost allocators used by legacy National Grid USA
3 and KeySpan Companies.

4 Q. Please explain why the revisions to the general
5 allocator and other cost allocators are
6 necessary.

7 A. In the Service Company Panel at page 47, the
8 Company explains that, in anticipation of the
9 consolidation of its two separate financial
10 systems, National Grid USA's use of Peoplesoft
11 and KeySpan's use of Oracle, onto SAP, it is
12 revising its cost allocation methodologies to
13 allow for a common cost assignment and
14 allocation process. The Company employed a
15 consultant, PA Consulting Group, to review its
16 cost allocation practices and recommend a
17 methodology consistent with industry best
18 practices and capable of being implemented as
19 part of the US Foundation Project initiative.
20 National Grid plans to implement the recommended
21 and revised methodologies when its financial
22 systems are consolidated, a date targeted for
23 October 2012.

24 Q. What was the result of the review done by PA

1 Consulting?

2 A. PA Consulting has helped National Grid develop
3 new cost allocation policies and procedures that
4 include (1) a revised general allocator to be
5 used when there is no readily determinable cost
6 causative basis available to allocate costs; (2)
7 a cost causative process that will be
8 consistently applied and stresses the importance
9 of using direct assignment as a first
10 preference, and, if no direct assignment can be
11 made, provides a general allocator that bears
12 the closest relationship to cost causation, as a
13 second preference; and (3) a revised
14 comprehensive cost allocation manual.

15 Q. Please describe the general allocator that PA
16 Consulting has recommended.

17 A. PA Consulting has recommended that the Company
18 use a three-factor formula as a general
19 allocator. The consultant explains that this
20 three-factor formula is common in the utility
21 industry. Specifically, the consultant
22 recommends that the Company adopt what is known
23 as a Modified Massachusetts Formula, a three-
24 factor general allocator that uses gross margin,

1 net plant, and O&M expenses, equally weighted.

2 Q. Do you have any comments on any of the factors
3 being used?

4 A. Yes. In its report, shown in Exhibit __ (SCP-6)
5 page 18, PA Consulting indicates the O&M expense
6 portion of the allocator will exclude costs
7 allocated from the Service Company using the
8 general allocator. However, the report also
9 notes, "A Special Report will be required to
10 determine the amount to be excluded for Service
11 Company Charges based on the General Allocator.
12 This is the single significant exception to the
13 'transparency' guiding principle."

14 Q. Did the Company undertake an analysis to see how
15 its historic test year costs would change if the
16 revised allocation policies and procedures were
17 implemented?

18 A. Yes. These results are included in Exhibit __
19 (SCP-7). The Company's analysis shows that if
20 the revised allocation policies and procedures
21 had been put in place in calendar year 2011,
22 Niagara Mohawk's electric O&M costs would have
23 decreased by \$14.844 million and its gas O&M
24 costs would have increased by \$0.402 million.

1 Q. Are these amounts reflected in the Company's
2 rate year projection of O&M costs?

3 A. No. A normalizing adjustment was necessary to
4 remove labor expense reductions and any costs to
5 achieve the US restructuring efficiency savings
6 from the total change in costs that was
7 computed. The net change in costs from the use
8 of the new allocators after normalizing
9 adjustments is a decrease to electric O&M
10 expense of \$12.833 million and an increase to
11 gas O&M expense of \$0.359 million. Adjusting
12 these revised 2011 historic year amounts, and
13 adjusting for inflation of 4.2785%, results in a
14 total decrease to projected rate year O&M
15 expenses of \$13.008 million- a decrease of
16 \$13.382 million to electric and an increase of
17 \$0.374 million to gas.

18 Q. Do you have any adjustments to the Company's
19 projection of the allocation reclassification?

20 A. No. From our review of PA Consulting's cost
21 allocation review project report in Exhibit __
22 (SCP-6) and the new allocators derivation and
23 impact study in Exhibit __ (SCP-7), it appears
24 that PA Consulting did a thorough analysis in

1 deriving the proposed new general allocator and
2 also the cost causative allocation factors.
3 Having said this, however, it is important to
4 note that the true impacts of the change in
5 allocators will not be known until the US
6 Foundations Program and the consolidated
7 accounting system is implemented, when actual
8 results, rather than projected impacts, can be
9 analyzed. The specific allocators put in place,
10 including the amounts used for each component in
11 deriving the general allocator, will need to be
12 reviewed. We, therefore, recommend that, after
13 the consolidated accounting system has been in
14 place long enough that twelve months of actual
15 cost data are available, the Company undertake
16 an analysis of the actual impacts, as well as a
17 testing of transactions to assure they are
18 properly documented and allocated, and provide
19 the results of their analysis to the Commission.

20 **M. IS Transformation Initiative**

21 Q. What is the IS Transformation initiative?

22 A. National Grid has introduced a new operating
23 model for its information systems (IS)
24 organization, and termed it the IS

1 Transformation initiative. The IS
2 Transformation initiative involves a redesign of
3 the Company's IS organization, as well as
4 developing partnerships with various key vendors
5 for the delivery of IS services. Traditionally,
6 National Grid has delivered its IS services
7 primarily using in-house employees, with
8 external vendors providing support when needed.
9 Recently, National Grid developed and has
10 implemented a new service delivery model that
11 now uses external vendors for many of its IS
12 services, with some support from internal
13 resources.

14 Q. What types of services are included in the IS
15 Transformation initiative?

16 A. The IS Transformation initiative has seven sub-
17 segments that include: 1) Service Management
18 Integrator; (2) Enterprise Services; (3)
19 Networks and Communications; (4) Internet,
20 Collaboration, and email; (5) Managed Print
21 Services; (6) Application Development and
22 Maintenance (also known as Solutions Delivery);
23 and (7) Contact Center Technology - At Home
24 Agents.

1 Q. Please explain your review of the IS
2 Transformation initiative projected costs for
3 the rate year.

4 A. For each of the segments of the IS
5 Transformation initiative, in IRs DPS-66 (CAS-2)
6 and DPS-283 (DAG-35) we asked for a copy of the
7 sanction paper or, in the event a sanction paper
8 didn't exist, copies of internal documents to
9 senior management that would contain the same
10 type and level of information, as well as
11 confirmation of senior management approval of
12 each project. Each major project undertaken by
13 National Grid goes through a sanctioning
14 process. An executive summary and other
15 pertinent information, such as detailed
16 projected costs and benefits, as well as an
17 ultimate recommendation whether the project
18 should go forward or not, is presented in one
19 document for review and approval by National
20 Grid's executive management. Each segment of
21 the IS Transformation initiative was supported
22 by a sanction paper that had executive approval
23 to move forward.

24 Q. Please continue.

1 A. In addition to the request for sanction papers,
2 in IRs DPS-254 (DAG-33) and DPS-283 (DAG-35) we
3 asked for the costs and benefits of each IS
4 Transformation initiative segment as reflected
5 in the Company's rate year forecast, as well as
6 a reconciliation of the costs and benefits back
7 to the sanction papers. In its response to
8 those IRs, the Company indicated it
9 "inadvertently" failed to include certain IS
10 Transformation costs and savings in its filing
11 of the rate year forecast.

12 Q. What costs and savings were omitted from the
13 Company's filing?

14 A. There were numerous omissions, and apparently it
15 was not until the Company was responding to
16 Staff's IRs on the specifics of the IS
17 Transformation initiative, that it realized the
18 rate year forecast it developed for the rate
19 case filing was incomplete. The first omission
20 was noted in its response to IR DPS-254 (DAG-
21 33), a response that was dated June 29, 2012, a
22 full two months after the submission of the rate
23 case filing. In that response, it identified it
24 did not remove the 88 employees from the labor

1 forecast that were expected to be leaving the
2 Company due to the outsourcing of the Enterprise
3 Services segment. Not only did the Company
4 forget to remove the reduction of employees, it
5 also did not correctly reflect the increase in
6 contractor costs embedded within the Enterprise
7 Services contract.

8 Q. Was that the entire omission?

9 A. No. In its response to IR DPS-283 (DAG-35), the
10 Company again noted it "inadvertently" did not
11 normalize out an additional 14 employees, and
12 also that certain costs of both the IS
13 Transformation and the US Foundations Program
14 were omitted from the rate case forecast. This
15 particular IR response was dated July 2, 2012,
16 again a full two months after the rate case was
17 filed. A supplemental response to IR DPS-283
18 (DAG-35) was received on July 9, 2012. Until it
19 prepared that response, the Company could not
20 even determine what the overall projected IS
21 Transformation initiative costs and savings
22 would be for the rate year forecast, as the
23 analysis simply had not been done.

24 Q. Are the savings of the reduction of 102

1 employees that the Company neglected to take
2 into account in its rate year labor forecast now
3 reflected in the rate year revenue requirement?

4 A. Yes. In its Corrections and Updates filing, the
5 Company determined that the appropriate number
6 of additional employees needing to be removed
7 from its rate year labor forecast was equivalent
8 to 100 full time employees, with 98 employees
9 impacting the Niagara Mohawk's labor expense
10 forecast. The Company captured the savings
11 totaling \$2.085 million in labor expense and
12 \$0.645 million in benefits expense; these
13 savings are reflected in the Corrections and
14 Updates filing.

15 Q. What are the net costs for IS Transformation
16 initiatives that are projected to be incurred
17 for the rate year?

18 A. Based on the response to IR DPS-283 (DAG-35) and
19 the Company's Corrections and Updates filing, on
20 a total National Grid basis, the projected costs
21 for the rate year are \$61.021 million, with
22 23.38% allocated to Niagara Mohawk electric
23 operations and 5.06% allocated to Niagara Mohawk
24 gas operations. This equates to total projected

1 Niagara Mohawk costs of \$14.267 million electric
2 and \$3.088 million gas

3 Q. The Company filed its rate case on April 27,
4 2012. Why was the rate year projection for IS
5 Transformation costs and savings not available
6 at that time?

7 A. We do not know why, but it is completely
8 unacceptable for a company the size of National
9 Grid to file such an incomplete and inadequate
10 rate case, and then have to supplement its
11 filing more than two months later with data that
12 was available at the time it was preparing its
13 filing. When it became apparent from Staff's
14 audit and responses to IRs DPS-254 (DAG-33) and
15 DPS-283 (DAG-35) that the Company had not
16 accurately captured all components of the IS
17 Transformation initiative, a follow up IR was
18 submitted. IR DPS-367 (DAG-44) asked for a
19 roadmap from the actual historic test year costs
20 incurred to the projected rate year costs, for
21 all of the IS Transformation initiative segments
22 in their entirety, including any applied
23 normalization adjustments and any incremental
24 costs and savings that were reflected. The

1 Company was also asked how it "inadvertently"
2 failed to include various cost and savings
3 elements into its rate year forecast. In its
4 response to IR DPS-367 (DAG-44), the Company
5 attempts to offer some valid reason for its
6 inadequate rate year expenses forecasting, but
7 the reality is there is no acceptable excuse for
8 the inadequate job the Company did in compiling
9 its rate year forecast for the various IS
10 Transformation initiative segments.

11 Q. Did the Company provide the roadmap that you
12 requested in order to determine the proper rate
13 year forecast for the costs and savings of IS
14 Transformation initiatives?

15 A. Yes, between the responses to IR DPS-254 (DAG-
16 33), DPS-283 (DAG-35), DPS-367 (DAG-44), the
17 Company's Corrections and Updates filing, and an
18 IS review meeting held on July 25, 2012, the
19 Company was able to show how it started with the
20 actual historic year costs and came to the rate
21 year projection as provided in IR DPS-283 (DAG-
22 35).

23 Q. Did you perform more follow up audit work
24 subsequent to the responses to the various IRs

1 and the IS review meeting?

2 A. Yes. We submitted IR DPS-488 (DAG-80), in which
3 we requested detailed backup to the IS
4 Transformation initiative workpaper data
5 presented in Exhibit __ (ISP-15CU).

6 Q. Did the Company provide the requested
7 documentation in its response to IR DPS-488
8 (DAG-80)?

9 A. Yes. The backup documentation the Company
10 supplied in its response was required to verify
11 the adequacy of its rate year projection of
12 costs associated with the IS Transformation
13 initiative. In responding to IR DPS-488 (DAG-
14 80), the Company found it had supplied an
15 inaccurate rate year cost projection for the
16 Solutions Delivery segment. To correct for this
17 error, the Company notes its Corrections and
18 Updates rate year cost projection for the IS
19 Transformation initiative should be reduced by
20 \$886,000 (\$757,000 for electric; \$129,000 for
21 gas).

22 Q. Do you agree with the adjustment the Company
23 says is now needed?

24 A. Yes, we are in agreement and we have reflected

1 this adjustment in both of our electric and gas
2 revenue requirement exhibits.

3 Q. Do you have any additional comments?

4 A. Yes. We feel compelled to again note that there
5 is no excuse for this error in the Company's
6 filing. The Company needs to be more diligent
7 in its analysis and preparation of its rate year
8 cost projections. This error should have been
9 caught much earlier, before it even filed its
10 Corrections and Updates on July 16, 2012.

11 Instead the error was discovered only in
12 preparing its response to a Staff information
13 request, a response that was dated August 9,
14 2012, a mere three weeks before Staff's direct
15 testimony was due. The Company needs to be more
16 conscientious in preparing its rate case filing
17 so that errors similar to those that surfaced
18 with respect to the IS Transformation initiative
19 do not happen again.

20 **N. Inflation Factor Update**

21 Q. How did the Company calculate its general, or
22 GDP inflation factor for inflation occurring
23 between the historic test year and the rate
24 year?

1 A. The Company calculated its GDP inflation factor
2 using the values provided in the Blue Chip
3 Economic Indicators index. The Company's
4 calculations for its GDP inflation factor are
5 provided in its initial filing in Exhibit__(RRP-
6 8).

7 Q. What GDP inflation factor did the Company use in
8 its rate year forecast?

9 A. The Company's GDP inflation factor is 4.2785%,
10 calculated over a twenty seven month period
11 between the historic test year ended December
12 31, 2011 to the rate year ending March 31, 2014.

13 Q. Did the Company make any updates to its rate
14 year GDP inflation factor?

15 A. The Company did not update its rate year GDP
16 inflation factor in its Corrections and Updates
17 filing, but the Company did update the historic
18 test year base used to calculate the rate year
19 forecast with the rate year GDP inflation
20 factor.

21 Q. Do you know the O&M expense items affected by
22 the GDP inflation factor?

23 A. Yes. The O&M expense items affected by GDP
24 inflation factor are provided in the response to

1 IRs DPS-100 (ACL-7) and DPS-482 (DAG-74).

2 Q. Are you proposing an adjustment to the Company's
3 rate year GDP inflation factor?

4 A. Yes. We are proposing to update the Company's
5 GDP inflation factor to 4.0918% using the latest
6 known data from July 17, 2012.

7 Q. How did you calculate the updated GDP inflation
8 rate?

9 A. We first obtained quarterly GDP price indices
10 from the Blue Chip Economic Indicators on July
11 17, 2012. The quarterly GDP price indices are
12 from the periods of calendar year ended December
13 31, 2011 (calendar year) and rate year ended
14 March 31, 2014 (rate year). The average GDP
15 price indices for each year are 113.373 and
16 118.012 for the calendar year and rate year,
17 respectively.

18 Q. Please continue.

19 A. The difference between the calendar year and the
20 rate year GDP price indices is 4.639. This
21 difference is divided by the GDP price index
22 from the calendar year to come up with 4.0918%.
23 This is the percentage change between the
24 calendar year and the rate year.

1 Q. Are you proposing an adjustment to reflect this
2 more current estimate of inflation?

3 A. Yes. The inflation adjustment reduces O&M
4 expense by \$485,000 (\$413,000 for electric;
5 \$72,000 for gas).

6 Q. How did you calculate this adjustment?

7 A. In the response to IR DPS-482 (DAG-74), the
8 Company provided a list of the expenses to which
9 it had applied inflation in projecting the rate
10 year expense. We have used the Company's
11 compiled list and applied the updated inflation
12 rate to calculate our adjustment. To avoid a
13 double-count, we removed from this list any
14 Staff adjustments we have made elsewhere that
15 included an application of inflation. For
16 example, when we normalized out the specific
17 consultant expenses, as discussed in a prior
18 section of our testimony, we removed the amount
19 the Company had included in its rate year
20 forecast, including the portion of the cost
21 associated with the Company's inflation factor
22 of 4.2785%. We have removed the historic test
23 year amount of the specific consultant
24 adjustment, i.e. before inflation, from our

1 expense base used in calculating our inflation
2 adjustment.

3 Q. Please continue.

4 A. We then calculated the rate year inflation
5 forecast. The difference between Staff's
6 forecasted and the Company's forecasted
7 inflation amount is our total adjustment of
8 \$485,000.

9

10 **II. Taxes Other Than Income Taxes**

11 **A. Property Taxes**

12 Q. Please explain how the Company derived its rate
13 year property tax expense forecast.

14 A. As shown in Exhibit __ (RRP-5CU), Schedule 1,
15 Pages 3-4, the Company began with actual
16 property tax expense for the fiscal year ending
17 March 31, 2012 of \$182,147,655. The Company
18 then increased this amount by 3.2% in fiscal
19 year 2013 and fiscal year 2014 resulting in a
20 rate year increase of \$11,929,911. The Company
21 further increased this expense by forecasting
22 increases to property taxes associated with
23 incremental additions to plant in service.
24 These forecasted plant additions result in an

1 additional \$7,113,195 of rate year property
2 taxes, for a total requested rate year allowance
3 of \$201,190,761. Overall this represents a
4 10.5% increase from the fiscal year 2012.

5 Q. Do you agree with the Company's forecast?

6 A. No. We disagree with the Company's forecast for
7 the following two reasons. First, the Company's
8 growth factor of 3.2% is based on calendar year
9 data, but should be based on fiscal year data.
10 Second, the Company has incorrectly calculated
11 incremental additions to plant in service.

12 Q. Please explain your first point that the 3.2%
13 growth factor is based on calendar year data,
14 but should be based on fiscal year data.

15 A. To forecast the annual growth factor, the
16 Company used the increase in property taxes from
17 calendar year 2010 to calendar year 2011,
18 normalized to remove the effect of property tax
19 refunds. However, the Company should have used
20 the increase from fiscal year 2011 to fiscal
21 year 2012. The term "fiscal year" refers to the
22 twelve months ending March 31.

23 Q. Why should the Company use a fiscal year instead
24 of a calendar year?

1 A. The Company should use a time period that
2 coincides with the time period used in other
3 areas of the analysis. The Company's forecast
4 is done with fiscal year data and the rate year
5 is based on a fiscal year as well. As such, the
6 Company should use a fiscal year when
7 calculating the growth factor. Furthermore,
8 using a calendar year creates a disconnect by
9 leaving a three month gap between the calendar
10 year end and the start of the forecast.

11 Q. Why did the Company use a calendar year growth
12 rate?

13 A. On page 12 of the testimony of the Shared
14 Services and Customer Panel, the Company states
15 that this methodology is consistent with the
16 methodology approved by the Commission in the
17 2010 Electric Rate Case. However, in that case,
18 both the Company's forecast and the rate year
19 were based on a calendar year, therefore it made
20 sense to calculate the growth factor on a
21 calendar year as well. This is not the
22 situation in this case.

23 Q. What is the growth rate for fiscal year 2012?

24 A. From the data provided in response to IR DPS-281

1 (RLC-14), we calculated a growth rate of 1.06%,
2 as shown in the property tax workpapers in
3 Exhibit__ (SAP-4). Using this 1.06% growth rate
4 instead of a 3.2% growth rate decreases the
5 electric and gas property tax expense forecasts
6 by \$6,289,802 and \$1,743,151, respectively.

7 Q. Please explain your second point, that the
8 Company has incorrectly calculated incremental
9 additions to plant in service.

10 A. To calculate incremental additions, the Company
11 compared forecast additions to the five year
12 average of additions from 2005 through 2009.
13 However, the Company should have compared
14 forecast additions to additions during the same
15 time period used to calculate the growth rate.

16 Q. Why did the Company use a five year average of
17 additions?

18 A. On page 17 of the Shared Services and Customer
19 Panel testimony, the Company states that the
20 "3.2% growth factor implicitly incorporates
21 capital spending that is approximately equal to
22 its five-year historic average."

23 Q. Why is this incorrect?

24 A. A growth factor based on a certain historical

1 period, for example in the Company's case
2 calendar year 2011 over 2010, only incorporates
3 the impact of additions occurring during the
4 time period used in the calculation of that
5 growth factor. The taxes related to additions
6 from previous years would already be reflected
7 in the base year taxes used to calculate the
8 growth rate and so would not contribute to
9 increased taxes from additions during the period
10 of measurement. Therefore, additions from 2005
11 through 2009 would not impact the growth rate in
12 2011 at all.

13 Q. How should incremental additions to plant in
14 service be calculated?

15 A. As the Company's forecast is based on a one year
16 growth factor, plant in service additions from
17 one year should be compared to the forecast
18 additions to determine the incremental amount.

19 Q. What is your adjustment?

20 A. Using the most recent one year data to calculate
21 the incremental plant in service additions
22 decreases the electric and gas property tax
23 expense forecast by \$2,041,505 and \$565,781,
24 respectively.

1 Q. What is your rate year property tax expense
2 forecast?

3 A. Our rate year property tax expense forecast for
4 both electric and gas is \$190,550,522, which
5 represents a 4.61% increase over fiscal year
6 2012.

7 Q. Do you have any other comments on the property
8 tax expense forecast?

9 A. Yes. On page 14 of the Shared Services and
10 Customer Panel testimony, the Company states
11 that the recent property tax cap law does not
12 have any effect on their property tax expense
13 forecast because the law caps the tax levy,
14 whereas the Company's forecast of property tax
15 expense is based on tax bills, not the tax levy.
16 This logic is incorrect, however, as tax bills
17 are based in part on the tax levy. Generally,
18 the tax levy of the tax authority is determined
19 by reducing the approved fiscal year expenditure
20 budget by all other source of revenue. The
21 taxing authority divides the total tax levy by
22 the total amount of assessable property to
23 establish a tax rate. This rate is then applied
24 to a person or company's assessed property to

1 determine their tax bill. Ergo, any cap on the
2 tax levy will have an impact on tax bills and
3 will likely result in moderating future tax
4 increases.

5 Q. Are you proposing an adjustment to reflect the
6 effect of the state's 2% property tax cap on the
7 Company's rate year forecast?

8 A. No. As this legislation is fairly recent, we do
9 not yet have enough data to accurately compute
10 the impact on property tax expense. However,
11 because our 1.06% growth rate is based on tax
12 data prior to the tax cap being implemented, it
13 does not reflect the impact and as such, is
14 generous.

15 **B. Payroll Taxes**

16 Q. You have proposed an adjustment to the rate year
17 labor forecast of \$14,407,700, does the
18 Company's rate year forecast of payroll taxes
19 need to be adjusted for those proposed labor
20 adjustments?

21 A. Yes. A concomitant adjustment reducing rate
22 year payroll taxes by 7.39% of our proposed
23 labor adjustments is required. We have reduced
24 rate year payroll taxes by \$1.061 million

1 (\$0.886 million for electric; \$0.175 million for
2 gas).

3 Q. How did you derive your 7.39% payroll tax rate?

4 A. The Company's rate year forecast of payroll tax
5 expense is \$20.7156 million as set forth in
6 Exhibit __ (RRP-5CU), Summary, Page 2. The
7 Company's rate year forecast of labor expense is
8 \$280.1745 million as set forth in Exhibit __
9 (RRP-3CU), Summary, Page 2. Dividing these two
10 dollar amounts results in payroll taxes being
11 7.39% of labor costs.

12 Q. Are you proposing any other adjustments to
13 payroll taxes?

14 A. Yes. As noted in the Company's response to IR
15 DPS-395 (DAG-50), the Company's rate year
16 payroll tax forecast should be reduced by \$3,800
17 to reflect the removal of one additional full-
18 time equivalent employee associated with US
19 Restructuring.

20

21 **III. Rate Year Deferrals**

22 **A. Overview - Electric Deferrals**

23 Q. Would you please list the electric revenue,
24 expense, and capital categories for which the

1 Company is requesting deferral or true-up
2 ratemaking treatment in this rate case?

3 A. As indicated in its response to IR DPS-380(DAG-
4 46), the Company is seeking to continue
5 currently in-place deferrals from the previous
6 electric rate case, Case 10-E-0050, for the
7 following revenues and expenses: pension
8 expenses, other post employment benefits (OPEBs)
9 expenses, low income discount program, economic
10 development fund, auction debt true-up, service
11 quality assurance program, and legislative or
12 regulatory changes. In addition, as stated in
13 the direct testimony of the Revenue Requirements
14 Panel at pages 103-125, the Company proposes to
15 maintain current ratemaking treatment of RPS
16 program costs, SBC program costs, aggregation
17 fee, voltage migration fee, temporary state
18 assessment 18-A, electric supply reconciliation
19 mechanism as well the new hedge adjustment and
20 legacy transition charge (formerly known as the
21 Commodity Adjustment Clause), Transmission
22 Revenue Adjustment Clause, NYPA Residential
23 Hydropower Benefit Reconciliation, NYISO Tariff
24 Schedule costs - Schedules 1 and 2 for any NYISO

1 rebills, and generation stranded cost
2 adjustments.

3 Q. Is the Company requesting any new deferrals or
4 true-ups in this rate case?

5 A. Yes. The Company is also requesting the
6 following new or revised deferrals/true-ups:
7 NERC Compliance rules, generating plant
8 closures, NYPA discounts, variable pay,
9 transmission tower painting, modifications to
10 the extraordinary storm costs, site
11 investigation and remediation (SIR), and
12 economic development grant program.

13 Q. Are you in agreement with the continuation of
14 the specific deferrals as proposed by the
15 Company?

16 A. Yes, with one exception. Absent from the
17 Company's discussion of deferrals is the
18 deferral for tax and accounting changes that are
19 externally imposed or internally adopted. We
20 are not sure if this was an oversight or not,
21 but Staff's recommendation is that the tax and
22 accounting change deferral continue as currently
23 designed, for both the sub-categories of
24 externally imposed or internally adopted

1 changes. This specific deferral is one of the
2 deferrals contained in the Case 10-E-0050 Rate
3 Plan Provisions (RPP) report, adopted by the
4 Commission on July 17, 2012.

5 Q. What is the Company's proposal with respect to
6 the RPP?

7 A. The Company proposes to continue the provisions
8 and incorporate them into the electric and gas
9 rate plans that have been established in this
10 proceeding, except to the extent it has proposed
11 any modifications throughout the filing.

12 Q. Has the Company proposed any modification to the
13 tax and accounting change deferral as contained
14 in Section 1.2.1 of the RPP?

15 A. Not that we are aware. Staff's recommendation
16 is that the tax and accounting change deferral
17 continue as is with no modifications.

18 Q. What is Staff's position on the proposed new
19 deferrals?

20 A. Staff's Electric Infrastructure Panel discusses
21 the new deferral requests associated with the
22 NERC Compliance rules, generating plant
23 closures, transmission tower painting, and the
24 extraordinary storm costs and storm fund.

1 Staff's Site Investigation and Remediation Panel
2 discuss SIR costs, the Staff Electric Rates
3 Panel addresses the NYPA discount deferral, and
4 the Consumer Issues Panel is responsible for the
5 economic development grant program. We are in
6 agreement with the Company's proposal for the
7 variable pay deferral for any under spending of
8 the amount allowed in rates.

9 **B. Overview - Gas Deferrals**

10 Q. Would you please list the gas revenue, expense,
11 and capital categories for which the Company is
12 requesting deferral or true-up ratemaking
13 treatment in this rate case?

14 A. As indicated in its response to IR DPS-380(DAG-
15 46), the Company is seeking to continue
16 currently in-place deferrals from the previous
17 gas case, Case 08-G-0609, for the following
18 revenues and expenses: pension expenses, OPEBs
19 expenses, low income discount program, SIR
20 expenditures, deferred auction debt true-up, and
21 service quality assurance program. In addition,
22 as stated in the direct testimony of the Revenue
23 Requirements Panel at pages 103-125, the Company
24 proposes to maintain current ratemaking

1 treatment of SBC program costs, temporary state
2 assessment 18-A, GAC surcharge/refund
3 adjustment, non-core revenue sharing, and the
4 accrued unbilled revenue deferral.

5 Q. Is the Company requesting any new deferrals or
6 true-ups in this rate case?

7 A. Yes. The Company is also requesting the
8 following new or revised deferrals/true-ups:
9 Pipeline Safety Act of 2011, economic
10 development grant program, variable pay,
11 temporary deferral balance refund, modifications
12 to the regulatory, legislative and accounting
13 changes, Empire Zone Rider (EZR) deferral,
14 revenue decoupling mechanism (RDM), merchant
15 function charge (MFC), and net revenue sharing
16 mechanism.

17 Q. Are you in agreement with the continuation of
18 the specific deferrals as proposed by the
19 Company?

20 A. Yes.

21 Q. What is Staff's position on the proposed new
22 deferrals?

23 A. The Gas Rate Panel is addressing the proposed
24 changes to the RDM, the MFC and the net revenue

1 sharing mechanism. The Pipeline Act of 2011
2 deferral is addressed by Staff witness
3 Maioriello, and the Consumer Issues Panel is
4 responsible for the economic development grant
5 program and EZR deferral. As for the
6 modifications to the regulatory, legislative and
7 accounting changes, the Company proposes to
8 replace the term "accounting change" with "court
9 change" to make the deferral for the gas
10 business similar to the proposed deferral for
11 the electric business as included in the RPP.
12 We agree with the Company's modification, as it
13 makes sense to apply the same language to both
14 electric and gas operations.

15 Q. What is the Company's proposed language for gas
16 accounting change deferrals?

17 A. The Company did not make a specific proposal for
18 gas accounting changes. The Revenue
19 Requirements Panel testimony only states that
20 the Company will address any accounting changes
21 outside of the operation of the proposed
22 regulatory, legislative, and court change
23 deferral provision. That is too ambiguous a
24 response, especially in light of the significant

1 history of dispute that occurred in the last
2 electric rate case over accounting changes.

3 Q. What is your recommendation?

4 A. As we have just agreed that it makes sense for
5 the electric and gas operations to have the same
6 deferral for the regulatory, legislative and
7 accounting changes, the same is true of the
8 "accounting change" portion of the previous gas
9 deferral. We propose that the same language
10 that is contained in the RPP for accounting
11 changes, be applicable for gas operations.

12 Q. What is your recommendation on the variable pay
13 deferral as proposed by the Company?

14 A. We are in agreement with the Company's proposal
15 for the variable pay deferral for any under
16 spending of the amount allowed in rates.

17 Q. Please explain the Company's proposed new
18 deferral for the temporary deferral balance
19 refund.

20 A. This simply represents the Company's proposal to
21 amortize the projected net gas deferral balance
22 as of March 31, 2013 over three years. As
23 discussed earlier, this would be accomplished
24 outside of base rates, similar to the electric

1 deferral surcharge that was implemented January
2 1, 2012.

3 Q. Are you in agreement with this proposal?

4 A. We agree with the concept, but due to Staff's
5 proposed base rate decrease, we are recommending
6 no amortization of the projected net gas
7 deferral balances at this time. If however, the
8 Commission's ultimate decision results in a rate
9 increase, we would recommend amortizing a
10 portion of the deferred credit balance as an
11 offset.

12 **C. Pre-Rate Year Deferrals**

13 **1. Federal Income Taxes – Repair Costs**

14 Q. Would you please provide some background
15 information on this issue?

16 A. Before its 2009 fiscal year, Niagara Mohawk
17 capitalized routine repair maintenance costs for
18 federal income tax purposes. Beginning in 2009,
19 the Company changed its method of accounting,
20 and instead began expensing the routine repair
21 maintenance costs. In response to IR DPS-144
22 (DAG-21), the Company's calculation on
23 Attachment 1 indicates that, for federal income
24 tax purposes, this change resulted in a 2009 tax

1 benefit for gas operations of approximately \$53
2 million. In response to IR DPS-396 (DAG-51),
3 the Company updates the calculated tax benefit
4 received from 2009 to March 31, 2013 for gas
5 operations to be a total \$91.4 million.

6 Q. What is the required ratemaking for this
7 accounting change?

8 A. Under the terms of the Joint Proposal in Case
9 08-G-0609, the gas portion of the cash flow
10 enhancement resulting from this tax accounting
11 change must be deferred for the future benefit
12 of ratepayers. Section 4.2.1 of the Joint
13 Proposal requires the Company to establish a
14 deferred credit for the gas portion of the cash
15 flow enhancement resulting from this accounting
16 change, as long as the individual change has an
17 impact that exceeds \$2.283 million in any year.

18 Q. How much in required deferred ratepayer credits
19 has been recorded for this Company acknowledged
20 accounting change?

21 A. The Company has not recorded any gas deferred
22 credits for the future benefit of ratepayers.

23 Q. Has this issue ever been presented to the
24 Commission for determination?

- 1 A. Yes. In Case 10-E-0050, Niagara Mohawk's most
2 recently litigated electric case, this very
3 issue, for both the electric and gas cash flow
4 enhancements, was addressed by Staff and
5 presented to the Commission for determination.
6 For the very same reasons asserted here, Staff
7 recommended the cash flow enhancement benefits
8 of the tax accounting change should accrue to
9 the benefit of ratepayers. In both the ALJs
10 Recommended Decision and the Commission's Order,
11 Staff's recommendation was adopted, but for the
12 electric operations only. Both the ALJs and the
13 Commission were silent as to the appropriate
14 ratemaking treatment for the cash flow
15 enhancements benefits of the gas operations. We
16 have here the same exact issue as before, except
17 that it relates to gas operations.
- 18 Q. How did the ALJs and the Commission address this
19 issue on the electric side?
- 20 A. The ALJs agreed with Staff, stating that "... the
21 change Niagara Mohawk made for tax accounting
22 purposes was also a financial and regulatory
23 accounting matter that affected the operations
24 of the existing rate plan in the year in which

1 the company made the change. The rate plan
2 contemplated the possibility of accounting
3 change and matters of this sort, and the
4 regulators who adopted the multi-year plan
5 insisted that the benefits of accounting changes
6 inure to ratepayers and be captured for them.
7 Ratepayers are exposed to the consequences of
8 adverse tax changes and accounting requirements
9 for which they are responsible. It is only fair
10 that ratepayers receive the countervailing
11 benefits of any tax and financial statement
12 improvements, when available."

13 Q. Please continue.

14 A. The Commission stated in its Order, "Initially
15 we must point out that the Merger Joint Proposal
16 is not a contract and its provisions are not to
17 be parsed in the manner the Company has
18 attempted here to determine its proper
19 operations during the term of the rate plan for
20 ratepayers and shareholders alike. In ruling on
21 the issue raised here, we look to the regulatory
22 purposes and objectives that the Merger Joint
23 Proposal is intended to serve and our actions
24 are in keeping with the proper achievement of

1 these goals. The Merger Joint Proposal was
2 crafted to cover substantial changes in material
3 items that alter the Company's ongoing
4 operations from those in place at the time the
5 Merger Joint Proposal was adopted. It
6 recognizes that such changes can go in both
7 directions and they can be either advantageous
8 or disadvantageous to the Company. The Merger
9 Joint Proposal provides the Company protection
10 from unknown, adverse changes and it captures
11 for ratepayers advantages that were not and
12 could not be known at the time it was adopted."
13 The Commission found "the change in federal
14 income tax practice in 2009 was material and it
15 achieved a significant cash flow reduction that
16 is both captured by the Merger Joint Proposal
17 and inures to the benefit of the ratepayers who
18 have also been paying a large body of deferred
19 costs that built up during the course of the
20 Merger Joint Proposal." The Commission agreed
21 with the ALJs and required the cash flow
22 enhancement be treated as a deferred credit.
23 Q. If the Commission previously ruled that the cash
24 flow enhancement should be treated as a deferred

1 credit, why has the Company not yet recorded any
2 gas deferred credits for this tax accounting
3 change?

4 A. In IR DPS-144 (DAG-21), the Company presents
5 three reasons it believes the Commission would
6 reach a different conclusion for the treatment
7 of gas cash flow enhancement benefits. The
8 first is because the Commission did not adopt
9 Staff's recommendation to establish a gas
10 deferred credit even though the issue was
11 addressed in both testimony and briefs. The
12 second reason is that the Company claims the
13 wording of Section 4.2.1 of the Joint Proposal
14 in the gas case, Case 08-G-0609, which deals
15 with Regulatory, Legislative, and Accounting
16 changes, does not explicitly address tax changes
17 in any manner. Rather the section of the Joint
18 Proposal that is in question here, the Company
19 suggests, explicitly applies to "discrete
20 regulatory, legislative and accounting changes,"
21 of which the change in tax strategy for the
22 change to expensing the routine repair
23 maintenance costs, is not a product. Therefore,
24 it asserts that Section 4.2.1 does not apply.

1 Again the Company argues the word "accounting"
2 in Section 4.2.1 refers to changes in financial
3 accounting and not changes in tax strategy or
4 tax accounting.

5 Q. What is the Company's third reason?

6 A. The Company says that, in contrast to the
7 situation described by the Commission for Case
8 01-E-0075 and the electric Merger Joint
9 Proposal, the Company has not built up a
10 substantial amount of gas deferred assets, but
11 rather there is now a \$42 million credit balance
12 available to go back to customers. The Company
13 also mentions that the fairness concerns
14 presented by the Commission are not applicable
15 to its gas rates.

16 Q. Do you agree with the Company's reasons?

17 A. No. Similar to the circumstances presented in
18 Case 10-E-0050, the position is simply an
19 attempt to renege on the settlement terms it
20 agreed to in the previous gas case. First,
21 whether the Company terms it as a change in its
22 tax strategy or a change in tax accounting, it
23 is still an accounting change. This has already
24 been recognized by the ALJs in the last electric

1 rate case. Furthermore, as the Commission did
2 not dispute the ALJs findings that the Company's
3 actions were indeed considered to be an
4 accounting change, and that the benefits should
5 inure to ratepayers, it can be easily inferred
6 that the Commission supported the ALJs
7 conclusion. Since the situation in this case is
8 exactly the same as it was in the electric case,
9 it is logical to conclude that the Commission
10 would find the gas related cash flow enhancement
11 benefits rightly belong to the ratepayers, and
12 not the Company.

13 Q. What about the Company's argument that this is
14 not a discrete regulatory, legislative or
15 accounting change and thus Section 4.2.1 of the
16 gas Joint Proposal is not applicable?

17 A. The Company is quite simply wrong. The tax
18 accounting change that was implemented is most
19 certainly discrete and distinct. A very
20 specific change in the accounting for routine
21 repair maintenance costs for federal income
22 taxes was implemented. This is exactly the type
23 of event Section 4.2.1 was intended to cover.
24 This is, without question, a change of

- 1 accounting. Previously, Niagara Mohawk was
2 capitalizing these repair costs for tax
3 purposes; and now Niagara Mohawk is expensing
4 these repair costs for tax purposes. Changing
5 from capitalizing certain costs to expensing
6 those same costs for income tax purposes is a
7 change in accounting; it is that basic.
- 8 Relatedly, on pages 57 and 89-90 of its pre-
9 filed direct testimony, the Revenue Requirements
10 Panel itself proposes an accounting change to
11 begin expensing in the rate year gas general
12 equipment items under \$2,500 that are currently
13 being capitalized. This is the identical
14 situation to the tax accounting change for
15 repair costs - expensing items that were
16 previously being capitalized.
- 17 Q. Please address the Company's argument that
18 because there are already \$42 million in gas
19 deferred credits available for ratepayer
20 benefit, the Commission's fairness concerns from
21 Case 10-E-0050 are not applicable.
- 22 A. The Company's argument is illogical. It makes
23 no difference whether there are \$42 million of
24 gas deferred credits or \$42 million of gas

1 deferred debits sitting on the books, ready for
2 disposition to ratepayers. That would be like
3 saying no additional deferred storm, pension or
4 OPEBs costs can be booked because you already
5 have deferred debit balances for these items.
6 It is appropriate to judge each deferrable item
7 based on its own merits. In this case it is
8 clear, similar to the circumstances on the
9 electric side, that ratepayers are entitled to
10 100% of the tax cash flow benefit enhancements
11 from the time the Company took the tax deduction
12 to the beginning of the rate year.

13 Q. Do you have any further comments?

14 A. Just that, while we do not know what the
15 Commission was thinking at the time, it only
16 makes sense that "[t]he Commission did not
17 address the gas issue in any manner," because
18 the only case before it at that time was the
19 electric case.

20 Q. What is Staff's recommendation?

21 A. Under Clause 4.2.1 of the gas Joint Proposal in
22 Case 08-G-0609, a gas deferred credit of \$30.113
23 million must be established for the cash flow
24 enhancement related to this accounting change.

1 Q. How did you quantify this deferred credit
2 amount?

3 A. In response to IR DPS-396 (DAG-51), Attachment
4 1, the Company provides the quantification of
5 what would be the pre-rate year gas deferral
6 related to the federal repair cost deduction if
7 the Commission were to adopt Staff's
8 recommendation.

9 Q. Are you recommending the pre-rate deferral for
10 the federal income tax repair costs be treated
11 in the same manner the Company proposes for all
12 pre-rate year deferrals?

13 A. No. The Company proposes to amortize the total
14 projected balance of pre-rate year deferrals
15 over three years. Based on the Company
16 Corrections & Updates filing, the projected pre-
17 rate year deferral balance is a credit amount of
18 \$41.095 million, and the amount proposed to be
19 amortized in the rate year is \$13.698 million,
20 before any gross up for bad debt or revenue
21 taxes.. We do not feel it is appropriate at
22 this time to amortize any of the federal income
23 tax repair cost deferral as the Internal Revenue
24 Service has not issued its official revenue

1 procedure regarding the repair deduction
2 guidance on natural gas property. The Company
3 expects the guidance to be issued prior to the
4 end of calendar year 2012.

5 Q. Why is this important?

6 A. Although the Company implemented this tax
7 accounting change and has taken federal income
8 tax expense deductions for the repair costs
9 since 2009, the IRS has not signed off on the
10 amount of the Company's deduction. There is a
11 possibility that, with the issuance of the
12 repair deduction guidance, the Company's claimed
13 deducted amounts may need to be adjusted. We
14 therefore recommend, due to the size of the
15 current computed deferral, that the deferral be
16 set up and accrue carrying charges at the pre-
17 tax rate of return, but that it be held in
18 reserve and not passed back to ratepayers until
19 the IRS issues its guidance for natural gas
20 property.

21 **2. Carrying Charges on Pre-Rate Year**
22 **Deferrals**

23 Q. What is your proposal on accruing carrying
24 charges on pre-rate year deferral balances?

1 A. In the last electric rate case, Case 10-E-0050,
2 Niagara Mohawk was allowed to begin accruing
3 carrying charges on future deferred balances.
4 In the last gas rate case, Case 08-G-0609,
5 Section 4.5.1 of the Joint Proposal, the Company
6 could not accrue carrying charges on deferred
7 debit or credit balances, with the exception of
8 RDM or as otherwise specified in the Company's
9 tariffs. We now recommend the allowed carrying
10 charge treatment be the same for both electric
11 and gas operations. Therefore, the Company
12 should start accruing carrying charges on
13 deferred balances, cash items only, effective
14 April 1, 2013.

15 **3. Audit of Pre-Rate Year Deferrals**

16 Q. What is the status of Staff's audit of the pre-
17 rate year deferrals?

18 A. In the Case 10-E-0050 deferral recovery filing,
19 Attachment 2 of the Commission's December 16,
20 2011 Order contained a schedule showing the
21 status of Staff's audit on the December 31, 2010
22 electric deferral accounts balances. As of this
23 filing today, this status has not changed, the
24 deferral account balances noted still remain

1 open, as well as the deferrals that have
2 accumulated in calendar year 2011 and year to
3 date 2012. Staff committed to endeavor to
4 complete its audit, but due to resource and
5 workload constraints, the audit is not yet
6 complete.

7 Q. What is the status of the gas pre-rate
8 deferrals?

9 A. Staff has reviewed a limited number of the gas
10 Joint Proposal deferrals, but at this time
11 cannot sign off on an amount associated with
12 each deferral balance.

13 Q. Is it Staff's intention to resume auditing the
14 remaining open electric and gas deferral account
15 balances?

16 A. Yes, Staff will endeavor to complete the
17 deferral audit on open deferral account balances
18 and report back to the Commission any areas of
19 disagreements that cannot be resolved through
20 the traditional deferral audit process.

21

22 **IV. Service Company Costs**

23 Q. Would you please provide some background on
24 National Grid's service companies?

- 1 A. There are four service companies providing
2 services to National Grid affiliates. This
3 includes National Grid Service Company, KeySpan
4 Corporate Services LLC, KeySpan Utility Services
5 LLC, and KeySpan Engineering and Survey Inc.
6 The service companies provide various
7 centralized services to other National Grid
8 operating entities. National Grid is planning
9 to implement its US Foundation Program in
10 October 2012 to consolidate its finance, human
11 resources and supply chain systems on a single
12 SAP platform. At the same time, the legacy
13 KeySpan Corporate and Utility Service Companies
14 will be consolidated into the National Grid
15 Service Company.
- 16 Q. What are the centralized services the service
17 companies provide?
- 18 A. Examples of the services provided are financial
19 services, human resources services, information
20 technology services, and legal services, to name
21 a few. The services provided are identified in
22 the service company agreements that Niagara
23 Mohawk has entered into and filed with the
24 Commission.

1 Q. Can you give an overview of the various service
2 company related concerns and issues identified
3 in the last electric case, Case 10-E-0050?
4 A. As shown by the Company in the direct testimony
5 of its Service Company Panel at pages 18-19,
6 some of the key service company issues were (1)
7 whether National Grid's business structure
8 lacked internal procedures and safeguards
9 necessary to ensure proper allocation of service
10 company costs to operating companies; (2)
11 whether National Grid's cost allocation
12 methodology properly credited Niagara Mohawk for
13 the economies of scale it creates as the largest
14 US based operating company in the National Grid
15 system; (3) whether Niagara Mohawk properly
16 normalized historic test year service company
17 charges; (4) the difficulties in auditing
18 service company costs assessed to Niagara
19 Mohawk; (5) the service companies' lack of
20 operating budgets and variance reporting; (6)
21 the lack of review of service company charges at
22 the operating company level; and (7) the
23 personnel from the service companies making the
24 decision as to what services Niagara Mohawk

1 should take rather than Niagara Mohawk personnel
2 independently making those decisions.

3 Q. Were any additional independent audits initiated
4 because of the issues raised in Case 10-E-0050?

5 A. Yes, two separate audits were initiated.
6 National Grid retained Liberty Consulting to
7 conduct an independent review and evaluation of
8 the affiliate relationships and transactions
9 addressing all costs affecting its US utility
10 operations. A copy of the Liberty report,
11 including the findings and recommendations, has
12 been provided as a response to IR DPS-465 (DAG-
13 66). In addition, in Case 10-M-0451, Overland
14 Consulting was retained by the Commission to
15 perform a historical review of National Grid's
16 allocation of service company costs to Niagara
17 Mohawk and other New York utilities over the
18 period of October 2008 through May 2010, as well
19 as service company affiliate policies and
20 procedures. Overland has not yet issued its
21 report with its findings.

22 Q. Do you have service company related concerns in
23 this case?

24 A. Yes, while some of the concerns expressed in the

1 last case have been alleviated, others remain.

2 Q. Please explain.

3 A. In Case 10-E-0050, one concern, as stated by the
4 ALJs in the Recommended Decision, and shared by
5 Staff, found that the structure of National
6 Grid's business organization around lines of
7 business and the service companies lacked the
8 internal procedures and controls necessary to
9 ensure the proper allocation of costs to the
10 individual operating companies. This specific
11 concern regarding corporate structure has been
12 mitigated by the Company's decision to change
13 from a global line of business model to a
14 regional and jurisdictional model. The
15 transition to the new structure was completed in
16 September 2011. The new structure is intended
17 to focus more on the needs of each separate
18 jurisdiction and the individual operating
19 entities within those jurisdictions. The
20 regulated entities of New York, Niagara Mohawk
21 and the KeySpan companies, now fall under the
22 leadership of a president in charge of the New
23 York jurisdiction.

24 Q. Have any other prior concerns have been

1 mitigated?

2 A. We performed a limited review of Niagara
3 Mohawk's historic test year charges, both
4 incurred charges from Niagara Mohawk itself and
5 from the services companies. From our review,
6 our previous concerns related to the
7 misallocation of service company charges to
8 Niagara Mohawk appear to have been addressed by
9 Company's actions over the last year. We did
10 not find any instances of cross-subsidization by
11 Niagara Mohawk of the other National Grid
12 affiliates. While we do have some normalization
13 of historic year costs concerns that are
14 discussed elsewhere in our testimony, they are
15 not of a service company cost allocation nature.
16 Also, the previous concern of the difficulties
17 in auditing service company costs assessed to
18 Niagara Mohawk did not reappear throughout our
19 current rate case audit. Our limited review of
20 the historic year service company costs was done
21 without the difficulties and constraints that
22 previously existed.

23 Q. Are there any concerns from the last electric
24 case that continue?

1 A. Yes. While we have no specific numerical
2 adjustment to make in this case resulting from
3 our review of individual service company
4 transactions and their accounting and
5 allocation, we have several service company
6 concerns that continue to exist today.
7 Specifically we have concerns associated with
8 the Company's service level agreements, the
9 review and approval of the monthly service
10 company bill, and the monthly budgeting and
11 review process. Each of these concerns is
12 addressed below.

13 Q. What is a Service Level Agreement?

14 A. The Company, at page 18 of the Service Company
15 Panel's testimony, describes SLAs, the service
16 level agreements, as agreements between National
17 Grid's functional areas and the president of
18 National Grid's Niagara Mohawk operations that
19 set forth the levels and cost of services
20 provided by the functional groups to the
21 jurisdictional entities. In response to IR DPS-
22 484 (DAG-76), the Company provided copies of the
23 current versions of its US SLA Governance
24 Handbook, SLA agreements between the various

1 functional providers and Niagara Mohawk, and the
2 service agreements as filed with the Commission
3 on March 30, 2012.

4 Q. Please explain how the service agreements that
5 are filed with the Commission differ from the
6 SLAs.

7 A. Service agreements are legal contracts between
8 the specific operating company and the service
9 company that set out the terms for the
10 provisions of services being performed. The
11 SLAs, as designed, are non-legally binding
12 performance management tools that define the
13 relationship between the functional service
14 provider and the recipient of the services.

15 Q. Do you have any comments on the SLAs provided by
16 the Company?

17 A. Yes, we have concerns with the SLAs as currently
18 designed. The Liberty Consulting report,
19 provided in response to IR DPS-465 (DAG-66), was
20 issued March 21, 2011, and contains discussion
21 and recommendations on SLAs. In particular, at
22 page 63 of Attachment 1 of the report, Liberty
23 states, "The design and use of SLAs emerged as a
24 significant issue in the NYPSC management audit

1 of Grid in 2009. Grid's response remained a
2 work in progress during the Liberty audit.
3 Liberty has provided Grid with recommendations
4 for SLA design, content and use. We have also
5 emphasized the need to see them in the broader
6 and overriding context of service-cost
7 management. A new perspective on SLAs and
8 service-cost management has emerged as a result
9 of the shift to a regional organizational model.
10 Liberty believes the judicious design and
11 application of SLAs will form a central element
12 in making the regional model effective." In
13 Appendix 2 of the same report, Liberty provided
14 a listing of a general set of criteria that it
15 recommended in the Company's design of the new
16 SLAs, including areas such as Service
17 Definition, Cost and Pricing, Planning and
18 Budgeting, Choice, Accountabilities, and
19 Performance Standards and Measures. In IR DPS-
20 501 (DAG-85), we requested the Company show
21 where and how the current design of the
22 Company's SLAs reconciles to and incorporates
23 the suggested criteria for the SLA design
24 provided by Liberty. In its response, the

1 Company indicates it has addressed all the
2 criteria suggested by Liberty.

3 Q. Do you agree?

4 A. No, we do not think the SLAs, as currently
5 designed, adequately address Liberty's
6 recommendations.

7 Q. Please explain.

8 A. The SLAs provided by the Company in response to
9 IR DPS-484 (DAG-76) do not contain pricing
10 information, such as price and quantities of
11 services to be provided, and 11 of the 16 SLA's
12 do not contain key performance indicators. The
13 SLAs contain no provisions for bench marking or
14 market testing of the services that are provided
15 to Niagara Mohawk. Such provisions are
16 necessary to ensure the costs are competitive
17 with the pricing of non-affiliated vendors or of
18 Niagara Mohawk performing the service itself.

19 Q. Why is it necessary the SLAs contain this
20 information?

21 A. For the types of centralized services being
22 provided by the service companies, the costs
23 incurred and paid for by Niagara Mohawk should
24 be coming from the most cost effective provider,

1 whether from an affiliate, a non-affiliated
2 vendor or Niagara Mohawk itself. Niagara Mohawk
3 needs to have the information so it can monitor
4 the cost of the services provided by the SLAs
5 and the corresponding service agreements.
6 Without it, the Company cannot compare the costs
7 of the services being provided and determine
8 whether receiving the services from its
9 affiliates is the most cost effective
10 alternative.

11 Q. Are the centralized service costs charged to
12 Niagara Mohawk considered to be a significant
13 amount?

14 A. Yes, this is confirmed by reviewing just a few
15 of the draft SLAs provided in response to IR
16 DPS-484 (DAG-76). Attachment 4 of this response
17 is the draft SLA between the Finance functional
18 service provider and Niagara Mohawk for the
19 period August 1 through March 31, 2012. The
20 controllable operating expense budget for
21 Niagara Mohawk for the Finance functional area
22 is \$31.300 million. It is important to note
23 this total amount portrayed is not solely the
24 estimate of allocated costs from the centralized

1 service companies, but includes direct charges
2 to Niagara Mohawk as well. Attachment 7 of the
3 response is the draft SLA between the
4 Information Services functional service provider
5 and Niagara Mohawk, with the controllable
6 operating expense budget for Niagara Mohawk of
7 an amount of \$37.700 million. Similarly,
8 Attachment 14 is draft SLA between the Shared
9 Services functional service provider and Niagara
10 Mohawk, with the controllable operating expense
11 budget for Niagara Mohawk of \$75.548 million.
12 While there are sixteen SLAs in total, the
13 amounts for just these three SLAs are already
14 substantial.

15 Q. Is there a problem with the Company not
16 segregating out the budgeted direct versus
17 centralized service company amounts in the
18 various SLAs?

19 A. Yes, this exacerbates the problem we identified
20 previously regarding the SLAs being devoid of
21 pricing information of the services to be
22 provided by the service company. With the
23 expected service company costs not broken out
24 from the total budgeted operating expenses for

1 the functional area in the SLAs, Niagara Mohawk
2 cannot affirmatively determine that the costs
3 and services provided are reasonable.

4 Q. How does National Grid then assure the cost of
5 competitiveness of its services being provided
6 to Niagara Mohawk?

7 A. In Exhibit __ (SCP-2) page 7, item VI:R6, and
8 the response to IR DPS-468 (DAG-69), National
9 Grid indicates it uses a "deep dive" process,
10 which is considered to be a comprehensive
11 analysis of a function or service area that
12 addresses the business model or sourcing
13 opportunities. It could include benchmarking,
14 market testing and consultant services and where
15 appropriate, comparisons of obtaining the
16 services from alternative sources.

17 Q. What is your concern with the deep dive process
18 as explained by the Company?

19 A. The deep dive process addresses the benchmarking
20 from a high level type of overview, with the
21 specific details missing. The deep dive process
22 doesn't provide a comparison to the cost of
23 Niagara Mohawk obtaining the service from
24 another vendor or performing the service itself.

1 It only provides the allocated cost of National
2 Grid providing the service, which is only one
3 half of the comparison. As a result, it is not
4 a proper market test or benchmarking. These
5 deep dive and benchmarking details need to be
6 formulated and incorporated into the SLAs for
7 the SLAs to be an effective performance tool.

8 Q. What other SLA concerns do you have?

9 A. The SLAs should be incorporated into and be a
10 part of the legal service agreements Niagara
11 Mohawk enters into with the service companies.
12 The Company indicated in response to IR DPS-484
13 (DAG-76), that the description of services in
14 the SLAs will be aligned with the description of
15 services contained in the service agreement and
16 the service agreement will be referenced in the
17 SLAs. However, this does not go far enough.
18 Right now the SLAs are only a management
19 performance tool, but in order to assure that
20 Niagara Mohawk is receiving the most cost
21 effective service from its service company
22 affiliates, the SLAs should be part of the
23 legally binding document that governs the terms
24 of the services being provided.

- 1 Q. Please explain your concern with the review and
2 approval of the monthly service company bill.
- 3 A. In IR DPS-378 (DAG-45) we asked the Company for
4 an explanation and a copy of the Company's
5 written accounting policies and procedures in
6 place for its review of the service company bill
7 and its charges that are sent from the KeySpan
8 and National Grid service companies, and also
9 the process employed to review and determine
10 that the monthly service company charges to
11 Niagara Mohawk are appropriately incurred and
12 correctly allocated. The Company responded that
13 the bill is produced in Peoplesoft and Oracle
14 and available for viewing, but the bills are not
15 distributed or signed off on, and there is no
16 designated employee responsible for receiving
17 and reviewing the bill. Payments of the monthly
18 bills from Niagara Mohawk to the affiliate are
19 made monthly and not contingent on the review or
20 acceptance of the charges.
- 21 Q. If Niagara Mohawk does not review and approve
22 the bills before payment, what are the internal
23 controls in place to make sure the amount being
24 paid is correct?

1 A. The Company states there are multiple levels of
2 review for the service company costs being
3 charged. First, when an invoice is paid, or
4 payroll is charged, employees are advised that a
5 review of the accounting is required as part of
6 the approval process. Second, costs are
7 reviewed by various decision support teams to
8 compare them against budgeted amounts. Third,
9 fluctuation analyses are done by the accounting
10 group on income statements and balance sheets to
11 review changes year to year. Fourth, a detailed
12 review is currently being performed by the NY
13 Jurisdiction Finance team.

14 Q. What is the problem with the Company's review
15 process, or lack thereof?

16 A. The problem is that there is no one from the
17 Niagara Mohawk operating company who is
18 objectively or independently reviewing and
19 making sure the charges it is incurring from the
20 services companies are correct. The service
21 company personnel are verifying the accuracy and
22 appropriateness of its own bill calculations for
23 Niagara Mohawk. Furthermore, the intercompany
24 bill is automatically paid in lieu of any

1 review. The service company is to be considered
2 a vendor, similar to any other non-affiliated
3 third-party vendor, and is by far Niagara
4 Mohawk's largest vendor. One would expect the
5 Company would not pay a vendor's charges without
6 reviewing the bill and verifying the amount
7 being charged is correct, and certainly the
8 process should be no different in paying the
9 bill of its largest vendor.

10 Q. Was this issue discussed in any other forum?

11 A. Yes. This issue was discussed in the last
12 electric rate case, Case 10-E-0050; as well as
13 in the audit performed independently by Liberty
14 Consulting. In the audit that was undertaken by
15 Liberty, it applied certain criteria in
16 examining the affiliate billing process: (1)
17 that affiliate billing should be accurate,
18 timely and in the form of standard business to
19 business invoices; (2) that invoices must
20 provide clear and detailed information for the
21 services and goods provided that allow for the
22 evaluation of value and quality provided under
23 appropriate SLAs or intercompany agreements; (3)
24 that regulated operating companies must

1 individually review and evaluate each invoice
2 for accuracy and value provided; (4) that
3 invoice approvals be made by high level
4 operating company officers specified in
5 delegation of authority documents; (5) that the
6 invoice review and approval must provide a clear
7 audit trail and meet corporate and Sarbanes-
8 Oxley control requirements; and (6) that
9 settlement processes and recording of payments
10 must be timely, regular and auditable.

11 Q. Did Liberty make any findings as to how well the
12 Company operated within those criteria?

13 A. Yes. In its review, Liberty found that (1)
14 there was no review, evaluation, or payment
15 authorization regarding service company billing
16 to operating companies, or regarding billing
17 between operating companies; (2) service company
18 personnel effectively perform both ends of the
19 billing, review, and settlement processes; (3)
20 the mingling of roles impaired the ability to
21 address operating company interests; and (4) the
22 fact that the operating companies neither
23 regularly review nor use the company employees
24 to authorize payment of service company and

1 intercompany invoices indicates that the
2 specific interests of the operating companies do
3 not have sufficient focus in affiliate
4 transactions.

5 Q. Given these Liberty findings, did Liberty make
6 any recommendations?

7 A. Yes. Liberty recommended National Grid (1)
8 promptly establish consistent processes,
9 procedures and delegation of authority for the
10 independent review and approval of all
11 affiliated company bills by senior managers
12 accountable to each of the new regional
13 presidents for the operating companies; and (2)
14 strengthen processes, procedures, and culture to
15 emphasize the importance of properly questioning
16 and vetting charges for service company and
17 intercompany payment authorization with the
18 protection of operating company interests as
19 being top priority.

20 Q. What is your recommendation to address the
21 concern about the lack of independent review of
22 the service company bill and charges?

23 A. Ideally, the Company should designate personnel
24 who are solely Niagara Mohawk employees to

1 review and approve payment of the service
2 company bills and charges. In the alternative,
3 the Company could install an annual verification
4 process from an independent party that would
5 perform a service company bill review and
6 analysis, as well as transactional testing, so
7 assurance can be provided that service company
8 charges to Niagara Mohawk are appropriately
9 incurred and allocated. Also, payment to the
10 service company for its monthly bill should not
11 be automatic; a monthly review of the bill and
12 its charges should be performed, before payment
13 is made.

14 Q. Please describe the detailed review that has
15 recently begun being performed by the NY
16 Jurisdiction Finance team.

17 A. As described by the Company in its response to
18 IR DPS-378 (DAG-45), an additional level of
19 review is currently being performed by the NY
20 Finance group for the service company charges
21 coming to Niagara Mohawk. This review is
22 conducted through the monthly financial report
23 for Niagara Mohawk, a report that was first
24 implemented in October 2011. The monthly report

1 compares monthly and year to date functional
2 operating expenses to the budget and the prior
3 year, as well as provides a breakdown of
4 directly charged versus allocated costs. Each
5 functional group provides detailed analyses and
6 variance explanations, which is then reviewed by
7 the NY Finance group to ensure the incurred
8 charges are in line with expectations and that
9 the variance explanations address the deviations
10 from budgeted and prior year expense levels.

11 Q. Do you have any concerns with this new monthly
12 reporting and review process?

13 A. Yes. First, this review process is described as
14 an additional measure put in place that serves
15 as a review of service company charges to
16 Niagara Mohawk. As shown in the Company's
17 response to IR DPS-469 (DAG-70), the NY Finance
18 team is made up of National Grid personnel who
19 are service company employees. So, again, we
20 have service company employees undertaking a
21 process where they are reviewing and monitoring
22 their own charges, rather than an independent
23 review coming from Niagara Mohawk employees.
24 Second, the review process as described is

1 inadequate and ineffective in determining if the
2 service charges coming into Niagara Mohawk are
3 appropriately charged and allocated. While the
4 monthly reporting of actual versus budget
5 process may serve the process of highlighting
6 service company charge variances, it does
7 nothing to monitor, review and ensure that
8 service company charges are appropriately
9 allocated, especially in the event that actual
10 costs do not exceed the budgeted amount. One
11 cannot assume that just because there is no
12 variance, all service company costs have been
13 properly accounted for and allocated to Niagara
14 Mohawk. Furthermore, as indicated in response
15 to IR DPS-298 (DAG-39), budgets are developed
16 for each operating department housed within each
17 service company. So it is the National Grid
18 Service Company employees acting as Niagara
19 Mohawk management who establish the budgeted
20 service company amounts. From the start to the
21 end of the process, it is service company
22 employees deciding how much the services will
23 cost.

24 Q. What is the status of the concern identified in

1 the last electric case as to whether National
2 Grid's cost allocation methodology properly
3 credits Niagara Mohawk for the economies of
4 scale it creates as the largest US based
5 operating company in the National Grid system?
6 A. We do not have an opinion on that at this time.
7 The Company states in its Service Company Panel
8 testimony at page 54, "Both National Grid's
9 existing cost allocation procedures and the
10 revisions to those procedures that National Grid
11 is proposing in the context of the consolidation
12 of the service companies and the US Foundations
13 Program are designed to ensure that no entity is
14 cross-subsidized. These procedures also ensure
15 that cost reductions are allocated among the
16 operating entities in proportion to the level of
17 services that those entities receive from the
18 service companies." Similar to our discussion
19 on the allocator changes recommended by PA
20 Consulting, we cannot conclude that Niagara
21 Mohawk is receiving and benefitting from the
22 economies of scale to the extent it should be
23 until the US Foundations Program and the
24 consolidated accounting system is implemented,

1 and actual results can be analyzed. We,
2 therefore, recommend that, after the
3 consolidated accounting system has been in place
4 long enough that twelve months of actual cost
5 data are available, the Company undertake an
6 analysis that will show to what extent Niagara
7 Mohawk is actually receiving and benefitting
8 from the economies of scale, and that it is not
9 cross subsidizing any other affiliate. The
10 results of such analysis should be submitted to
11 the Commission.

12 Q. Turning now to management compensation, how much
13 of the labor compensation charges reflected in
14 Niagara Mohawk's rate year ended March 31, 2014
15 Operating and Maintenance expense (O&M) are from
16 the National Grid USA Service Company and
17 KeySpan Corporate Service Company (National Grid
18 Service Companies)?.

19 A. There is \$72.2 million of labor compensation
20 included in the National Grid service company
21 charges reflected in Niagara Mohawk's rate year
22 ended March 31, 2014 O&M expense forecast.

23 Q. Are you aware of the National Grid Service
24 Companies labor compensation comparison study

1 that was performed by Staff witness Schuler?

2 A. Yes. According to Staff witness Schuler, the
3 study shows that the compensation provided to
4 the employees of the National Grid Service
5 Companies is greater than that required for
6 similar employees with like experience in the
7 upstate New York labor market. This has
8 resulted in Niagara Mohawk incurring nearly \$3
9 million more in labor costs in the rate year
10 ending March 31, 2014 than if Niagara Mohawk
11 performed the services itself or, perhaps,
12 obtained the services from a more regionally
13 located vendor.

14 Q. Has Niagara Mohawk provided any comparisons for
15 the services provided by the National Grid
16 Service Companies to show that the costs of
17 obtaining the services from its affiliates is
18 competitive with the costs of Niagara Mohawk
19 performing the services with its own employees
20 or obtaining such services from another vendor.

21 A. No. Niagara Mohawk has provided no such market
22 testing or benchmarking of the National Grid
23 Service Companies' cost of services as just
24 described.

1 Q. Have any parties in the past recommended that
2 such market tests or benchmarking of the
3 National Grid Service Companies' allocated
4 service costs be done in order for Niagara
5 Mohawk to manage and control the costs of these
6 services.

7 A. In the Commission approved management audit
8 report submitted by NorthStar Consulting Group
9 (NorthStar) in Case 08-E-0827, NorthStar
10 recommended that Niagara Mohawk enter into
11 Service Level Agreements (SLAs) for those shared
12 services it would consider obtaining from the
13 National Grid Service Companies (see
14 recommendations IX-4, 5 and 6). As part of the
15 process of entering into such agreements,
16 NorthStar recommended that Niagara Mohawk make
17 such cost comparisons to assure that receiving
18 such services from its affiliates was beneficial
19 to its ratepayer. This is specifically covered
20 on page IX-20 of the management audit report, at
21 item #14 where it states, "The lack of formal
22 Service Level Agreements (SLA) severely limits
23 the ability of US Transmission and ED&G to
24 proactively determine and then control levels of

1 service and costs, and to compare costs with
2 alternative potential suppliers of those
3 services". It should be noted in this context
4 that Niagara Mohawk's electric operations at the
5 time were included under the US Transmission and
6 Electric Distribution and Generation lines of
7 business used by National Grid plc to organize
8 and manage its businesses during the time of the
9 management audit.

10 Q. Have any other parties recommended that Niagara
11 Mohawk perform such comparisons for those
12 services it receives from the National Grid
13 Service Companies?

14 A. Yes. As discussed previously, the Liberty
15 Consulting Group was retained by National Grid
16 plc to examine the accounting practices and
17 procedures related to its affiliate transactions
18 and specifically those between its service
19 companies and the affiliates receiving such
20 services. On page 54 of its report presented to
21 National Grid, included as the response to IR
22 DPS-465 (DAG-66), Liberty recommended that the
23 SLAs be implemented so as to provide the
24 utilities the ability to manage their service

1 costs with the ultimate test of being able to
2 assure their customers that they are getting the
3 best deal. In conjunction with the service cost
4 management process, Liberty also recommended a
5 formal program be developed for addressing the
6 competitiveness of internally provided services,
7 which would include benchmarking and market
8 testing. In Appendix 2 of the report, Liberty
9 provides suggested criteria for SLA design.
10 Under the cost and pricing section, Liberty
11 recommended that the competitiveness of the
12 services provided by the National Grid Service
13 Companies be documented and, if the pricing of
14 its services is judged not to be competitive, a
15 suitable cap should be established above which
16 utility customers are protected.

17 Q. How has Niagara Mohawk responded to such
18 recommendations requiring it to demonstrate the
19 competitiveness of obtaining services from its
20 affiliates?

21 A. Rather than perform market testing, Niagara
22 Mohawk has employed a "deep dive" process as
23 described in the response to IR DPS-468 (DAG-69)
24 and as mentioned earlier.

1 Q. Please explain why the "deep dive" process is
2 ineffective in demonstrating the competitiveness
3 of the services Niagara Mohawk obtains from the
4 National Grid Service Companies.

5 A. The "deep dive" process is ineffective since it
6 only considers the cost of the services as
7 provided through the National Grid Service
8 Companies. It does not compare the cost of
9 obtaining these services from alternative
10 sources. By not making such comparisons, the
11 competitiveness of obtaining these services from
12 its affiliates is not demonstrated. Niagara
13 Mohawk cannot demonstrate that it is obtaining
14 these services at the best price.

15 Q. Considering the results of Staff witness
16 Schuler's study showing the higher labor
17 compensation costs of the National Grid Service
18 Companies as compared with upstate NY labor,
19 explain the significance of Niagara Mohawk's
20 failure to require a demonstration of the
21 competitiveness of obtaining services from its
22 affiliates.

23 A. Staff witness Schuler shows that, due to the
24 organization and location of the National Grid

1 Service Companies' workforce, its compensation
2 costs are greater than having these service
3 performed by employees in the upstate labor
4 market region. Without performing market
5 testing it can't be assured that these higher
6 costs aren't mitigated by an appropriate
7 recognition of economies of scale in the
8 allocation of service costs to Niagara Mohawk,
9 so that costs of such services from its
10 affiliates are comparable with Niagara Mohawk
11 self provisioning these services or obtaining
12 such services from an alternate provider.

13 Q. Please provide your recommendation as to the
14 rate treatment of the higher National Grid
15 Service Companies' labor compensation costs
16 flowing to Niagara Mohawk.

17 A. It is recommended that these higher labor
18 compensation costs be excluded from the rate
19 year ending March 31, 2014 O&M labor expense
20 allowance for Niagara Mohawk. Niagara Mohawk
21 has not demonstrated that the cost of obtaining
22 services from its affiliates, which includes
23 such higher costs, is competitive with other
24 alternatives. Based on this, the indicated

1 higher cost should not be allowed to be
2 reflected in Niagara Mohawk's revenue
3 requirement.

4

5 **V. Overland Audit**

6 Q. Please describe the current status of the
7 independent audit being conducted by Overland
8 Consulting in Case 10-M-0451.

9 A. Overland Consulting was retained by the
10 Commission in Case 10-M-0451 to perform a
11 historical review of National Grid's allocation
12 of service company costs to Niagara Mohawk and
13 other New York utilities over the period of
14 October 2008 through May 2010, as well as
15 service company affiliate policies and
16 procedures. Overland has not yet issued its
17 report with its findings. While we recognize
18 the audit is currently ongoing, we expect the
19 Overland audit report to be issued and brought
20 before the Commission during the pendency of the
21 rate case but sometime after Staff direct
22 testimony is filed.

23 Q. Do you expect there to be any effect on the rate
24 case once the Overland audit report is issued

1 and delivered to the Commission?

2 A. We would expect the Commission Order in Case 10-
3 M-0451 to provide direction as to whether and
4 how the results should be incorporated into this
5 pending rate case.

6 Q. Does this conclude your testimony at this time?

7 A. Yes.