DIRECT TESTIMONY OF REGINA L. TRUITT

Q. Please state your name and business address.

A. My name is Regina Truitt. My business address is 6363 Main Street, Williamsville, NY 14221.

Q. By whom are you employed and in what capacity?

A. I am employed by National Fuel Gas Distribution Corporation ("Distribution" or the "Company") as a Senior Manager in the Rates and Regulatory Affairs Department.

Q. Please state briefly your educational background and experience?

A. I graduated from the State University of New York at Buffalo in 1979 with a Bachelor of Science Degree in Accounting. In 1979, I was employed by the New York State Department of Public Service (DPS”). My work there involved examinations in rate proceedings, financings, fuel adjustment clause audits and in general accounting matters. I advanced to a Public Utilities Auditor II while employed at the DPS.

In 1985 I left the DPS and was employed by Metropolitan Transit Authority of Harris County in Houston, Texas. In September 1986, I joined Distribution.

Q. Have you previously testified before this Commission?

A. Yes, I have previously testified before this Commission, in many proceedings, including the Company’s last rate case proceeding, Case 07-G-0141.

Q. What is your responsibility in this proceeding?

A. I am responsible for the presenting the information required for a forecast of the twelve months ending (TME) May 31, 2014. This includes a calculation of the forecasted income statement and rate base for TME May 31, 2014 as shown on Exhibit___(RLT-1) and all of its associated components.

Q. What is shown on Exhibit___(RLT-1), Schedule 1, Sheet 1?

A. Exhibit___(RLT-1), Schedule 1 shows the income statement for the TME September 30, 2012, the basis for the Commission's concern as to the earnings of Distribution, and the forecasted income statement for the TME May 31, 2014. The remaining pages of Exhibit___(RLT-1), Schedule 1 are supporting schedules supporting the various line items on Sheet 1.

Q. How many ways are there to define earnings for a particular twelve month period?

Q. The Commission has stated in its order instituting Case 13-G-0136 that "The latest earnings calculation provided by the Company based on a 50% equity ratio for the twelve months ended September 30, 2012, showed an earned unadjusted ROE of 12.77%. National Fuel made normalizing adjustments that appear to reduce the ROE to 11.87%. However, after adjusting the Company's calculation for the 44.35% equity ratio allowed in its current rates and removing executive restricted stock and stock option compensation expense not allowed in current rates, Staff calculates that National Fuel earned a 13.15% equity return for the twelve months ended September 30, 2012." (page 2) Just in this paragraph,

earnings for the Company for the TME September 30, 2012 have been defined three ways.

Q. Why in this case is it possible to define earnings in different ways?

A. Distribution's last rate case was a fully litigated case and did not include a multi-year rate plan with an Earnings Sharing Mechanism. The Earnings Sharing Mechanism is the vehicle which defines the earnings calculation.

Q. Would you describe Exhibit___(RLT-1), Schedule 2?

A. Exhibit___RLT-1), Schedule 2 consists of four sheets. Each sheet contains many versions of calculating the earnings for Distribution for the TME September 30, 2012. Each sheet contains the income statement, the capital structure and the calculated ROE.

Sheet 1 begins with the Company's original response to local Staff's informal request for the earnings for September 30, 2012 and is shown in Columns A, B and C. Column A represents the income statement as shown on the Company's books. The Adjustments made in Column B transform the tax calculations from a book basis where Distribution is part of National Fuel Gas Distribution Corporation to a ratemaking basis. Column C is the result of those tax adjustments. Standard adjustments are made in Columns D and E which remove the Company's portion of Offsystem Sales (OSS) and Capacity Release Revenues (CRR) and the Stock Appreciation Rights (SARs) from the income statement. The resulting Column G is Staff's Income Statement before adjusting

the capital structure to 44.35% from the 50% capital structure that was used in the response to the informal request from Staff.

Column J shows the impact of changing the capital structure from 50% to 44.35% which leads to a calculated ROE of 13.12%. Staff changed the capital structure to 44.35% to reflect the amount allowed in Case 07-G-0141. Had Staff also changed the EB/Cap adjustment from $3,386,000 to $30,235,000, as is argued by Mr. Meinl, to reflect the amount allowed in Case 07-G-0141, the calculated ROE would have been 12.38% as shown in Column L.

Q. Please describe Sheet 2 of Exhibit___(RLT-1), Schedule 2.

A. Sheet 2 also presents Columns A-G as was presented on Sheet 1. The Capital Structure Adjustment changes the 50% Capital Structure to 48% Capital Structure, which is more representative of capital structures being allowed by today's Commission. This is described more fully in Mr. Meinl's testimony.

Q. Please continue with the description of Sheet 3.

A. Sheet 3 begins with Column G as shown on Sheets 1 and 2. The Capital Structure is changed to 55%, which is also described in Mr. Meinl's testimony. This changes the calculated ROE to 11.30%. Columns K,M and O add back to the income statement the savings the Company realized by being proactive on IRS issues, Property Tax Assessments and Labor and Benefit issues. If the Company were not proactive on the issues as discussed by Mr. Meinl, the calculated ROE would have been 7.77%, well below our "allowed" return.

Q. The Company was under a multi-year rate plan after acceptance by the Commission to a Joint Proposal in Case 04-G-1047 which contained an ESM. If the Company had agreed to a multi-year plan as an outcome of Case 07-G-0141 what would you speculate that the definitions of an ESM would contain?

A. The Company had been a party to multi-year rate plans from 1996 through the outcome of Case 07-G-0141. Based upon my experience with the negotiations of all of those rate plans, the definitions would have been very similar to that as contained in the ESM of Case 04-G-1047.

As shown, on Sheet 4, the calculated ROE would be 12.06%. The first three columns on Sheet 4 are the same columns as on Sheet 1. Per the ESM in Case 04-G-1047, the OSS and CRR would not have been removed. The SARs would have been removed and is shown in Column D. The EB/Cap would have been set at the amount in the Historic Test Year. The amount in Case 07-G-0141 was $30,235,000. Column G reflects the EB/Cap at this level. The agreement for the Capital Structure was to be “calculated be averaging the start and finish of each fiscal year of National Fuel Gas Company’s capital structure. The Common Equity component will be limited to the lower of actual average or 49%.” As the average Capital Structure was higher than 49%, I have changed the Capital Structure to 49% which leads to a calculated ROE of 12.06%.

Q. What is your final conclusion of the definition of earnings for the TME September 30, 2012?

A. As I demonstrated, there are many different ways the earnings could be calculated when there is not a definition agreed to as in a multi-year plans. But I think that it is clear from this Schedule that under no acceptable ratemaking definition for earnings is the Company earning higher than 12.41% (using 48% capital structure on Sheet 2) and that the only way to get to 13.15% is to use the outdated capital structure of 44.35%.

Q. What is shown on Exhibit___(RLT-2), Sheet 1?

A. Sheet 1 of Exhibit___(RLT-2) is the summary page of the revenues the TME May 31, 2014. This is presented by service class and is adjusted by the expected economic discounts to be given through the TME May 31, 2014. The Revenues are also adjusted for the surcharge revenues for reconcilable that have been forecast for the period. The reconcilable items consists of the RDM, MFC and the Symmetrical Sharing reconciliation surcharges. Other revenues are also presented and consist of late payment revenues and miscellaneous other revenues. Sheet 2 presents each service class and its associated volumes, revenues, gas costs, revenues taxes and margin.

Q. How were these volumes forecast for the TME May 31, 2014?

A. The Company prepares a five year sales forecast each year, by fiscal year (TME September), which is then priced out and included in the company's five year financial forecast. The sales forecast that is used in the instant proceeding was prepared in the beginning of 2012 and was priced out during June 2012. The forecast is done by month so the appropriate months were combined for the TME

May 31, 2014. A description of the sales forecasting methodologies and the forecast are included in the work papers also provided with this filing.

Q. Please describe how the revenues for the TME May 31, 2014 were determined.

A. Using the forecasted volumes by service classification by month, I have taken each service class's volumes and calculated the revenues by applying the rates currently in effect. For the SC-1, LIRA/LICAAP, EBD LIRA, SC-3, DSS sales, I used the Company's computer program which spreads service classification usage by block based on a historical bill frequency analysis for the class. The volumes by rate block were then multiplied by the base rates in effect since January 1, 2008 to develop base rate revenues, which were then summed to yield base rate revenues by service classification.

Q. Please continue with your description of the forecast of TME May 31, 2014 revenues.

A. The forecasted gas cost rates were developed in June 2012. The Revenue Tax was forecast by applying only the Gross Receipts Tax ("GRT") to the appropriate revenues. The total GRT rate charged to a customer is dependent upon whether or not the customer is residential or non-residential and resides in a city, town or village that applies an additional GRT tax to the customers. I have developed a composite GRT rate based on the average GRT paid by customers on the system. The composite rate was applied to the total of base rate revenues, Base Cost of Gas, Delivery Adjustment Charge and the Revenue Adjustment Revenues.

Q. What is the Revenue Adjustment Factor?

A. The Revenue Adjustment Factor is applied to the classes for which I used the Company's program to spread the total projected volume into the rate blocks. It was calculated in the forecast by comparing the previous fiscal year (FY 2011) calculated revenues by class with the actual revenues per class.

Q. What is the cause of the difference between the actual revenues and the calculated revenues?

A. The main difference between the actual and the calculated revenues in the previous fiscal year would be the allocation into the rate blocks. Each customer was billed according to the rate structure for that customer. As our current Customer Information System (CIS) cannot provide the actual volumes billed in each block for a rate class, a statistical methodology is used to break the total volumes for that service class into the rate blocks. The Company's OGIVE System to used the statistical methodology used to distribute the total volumes into each block. The OGIVE System employs a bill frequency analysis in determining the distribution of bill, by size and number, for a particular group of customers. The system captures bill frequency data from the Company's mainframe on a monthly basis. The system then takes the total forecasted monthly consumption and allocates the volumes into the various blocks of consumption.

Q. Are there other causes for a difference between actual revenues and the calculated revenues in the previous fiscal year?

A. Yes, adjustments to customers' bills would be the other variance between actual and calculated historic revenues.

Q. Why have you limited the use of the Revenue Adjustment Factor to those factors under the absolute value of 1%?

A. The purpose of using the Revenue Adjustment Factor is to calibrate the allocation of total projected TME May 31, 2014 volumes into the blocks. If the historic Revenue Adjustment Factor is greater than an absolute value of 1%, then it is likely that the bigger factor in the difference between the actual and calculated historic revenues involves adjustments made to the customers' bills during the previous fiscal year. This can be seen in the industrial classes where there are fewer customers and an adjustment may make a bigger impact than in a class where there are a lot of customers.

Q. How are the LIRA/LICAAP revenues calculated?

A. I have used the Residential rates to calculate the LIRA/LICAAP TME May 31, 2014 revenues. I then included a decrease in revenues of $6,000,000 to simulate the $6,000,000 associated with the discount, arrearage forgiveness, and administration of the programs associated with the program. This $6,000,000 was then reduced by $3,602,000 forecast for the arrearage forgiveness and administration costs which are reflected in Operations & Maintenance Expense (O&M). This leaves the rate discount of $2,398,000 in revenues.

Q. Please finish your description of the calculation of TME May 31, 2014 revenues.

A. The base rate revenue, the gas cost revenues, the Revenue Tax revenues and the Revenue Adjustment Factor Revenues are totaled to equal the TME May 31, 2014 revenues for each service class.

Q. Please turn to Exhibit___(RLT-2), Schedule 2, and explain this schedule.

A. Schedule 1 is a summary of O&M expenses detailed by elements of cost. It shows TME September 30, 2012 and TME May 31, 2014. I have applied inflation to every cost element with some exceptions.

Q. Please refer to Exhibit___(RLT-2), Schedule 2, Sheet 2, and explain in detail the computation of the adjustment to Labor.

A. I took the weekly payroll for the week ended December 29, 2012 as shown on Exhibit___(RLT-2), Schedule 2, Sheet 2. I multiplied that number by a factor of 52.14 weeks to derive an annualized base weekly payroll. To that I added the actual temporary, part-time, summer and other payroll for the twelve months ended December 31, 2012 and the actual overtime payroll for the twelve months ended December 31, 2012.

Then I annualized the supervisory and the executive payroll based on the pay period ended December 31, 2012 as shown on Exhibit___(RLT-2), Schedule 2, Sheet 2 by multiplying the base payroll by 24 as the supervisors and executives are paid twice a month. The executive payroll is the amount allocated to NY and booked directly to O&M.

Q. How did you determine the TME May 31, 2014 Labor Expense?

A. To forecast the TME May 31, 2014 labor expense, I started with the normalized payroll, as developed above, and added the forecasted wage increases for 2013 and 2014 as shown on Exhibit___(RLT-2), Schedule 2, Sheet 2. I have excluded the portion of the wage increase that would be allocated to outside of the TME May 31, 2014.

Q. What was the next step in your calculation?

A. Next I multiplied the calculated total TME May 31, 2014 payroll amount by 67.83%, the portion of payroll that will be expensed, as developed on Sheet 3 of Schedule 2 and described later in my testimony. Executive labor is allocated between companies and the NY portion is 100% O&M so that was directly added to the O&M portion of the supervisory and hourly payroll.

Q. Are there any further adjustments to Labor?

A. Yes. I have also added labor charged to New York from other jurisdictions to arrive at a total labor expense for the TME May 31, 2014 of $50,442,000 as shown on Exhibit___(RLT-2), Schedule 2, Sheet 1.

Q. How was the 67.83% O&M Expense Percentage calculated?

A. I have determined where labor was charged to during the TME September 30, 2012 and calculated the O&M percentage based on the labor charged to O&M versus total labor.

The percentage for the Benefit costs has been calculated by further adjusting the O&M Expense Percentage to reflect the benefit labor included in

the Benefit Loading Factor. This results in an O&M Expense Benefit Percentage of 67.09%.

Q. Please refer to the forecast for Employee Benefits, as shown on Exhibit___(RLT-2), Schedule 2, Sheet 4. Please describe this Schedule.

A. Sheet 1 summarizes for each benefit the TME September 30, 2012, the normalized amount and the forecasted TME May 31, 2014 forecast. The detailed computations of each benefit is also provided on sheets 5-13 and are explained below.

Q. Please refer to Exhibit___(RLT-2), Schedule 2, Sheet 5, and explain the computation of the adjustment for Group Life Insurance.

A. The Group Life Insurance Expense was inflated using the inflation factor described later in my testimony.

Q. Please refer to Sheet 6 and explain the detailed computation of the adjustment for Hospitalization.

A. National Fuel Gas Company became self-insured for its health insurance in 2004. Independent Health, a premium based cost to the Company, is also offered as an option for their health care.

To forecast the self-insurance portion of Health Care, I averaged the claims per employee for the twelve months ended September 30, 2012. I then multiplied that average by the number of active employees not choosing Independent Health.

For the Independent Health portion, I multiplied the number of active employees that are currently enrolled in Independent Health by the composite premium per employee.

The total monthly premium was then annualized and inflated by the inflation factor to produce a gross TME May 31, 2014.

Q. Please describe your forecast for Caremark Drug Coverage.

A. The premium and claim payments for Caremark Drug Coverage during the previous fiscal year were annualized to produce the normalized cost, which was then inflated by the inflation factor to project the TME May 31, 2014 cost.

The total annualized supervisory and weekly contributions were then subtracted from the projected health care cost to arrive at gross projected health care cost, which was multiplied by the 67.09% O&M Expense Benefit Percentage to calculate the amount to be charged to operations and maintenance expense.

Q. Please describe the forecasts for Pensions and Other Post-retirement Benefits (OPEBs).

A. Distribution has followed the Commission's Policy Statement on Pension and OPEBs since it was issued in 1993[1] I have chosen to reflect the current rate allowance for Pension and OPEBs in the instant filing

Q. Are all employees included in the Pension Plan?

[1] Case 91-M-0890 Statement of Policy and Order Concerning the Accounting and Ratemaking Treatment for Pensions and Postretirement Benefits Other Than Pensions, issued September 7, 1993 (Policy Statement)

A. No. To manage cost increases, the defined benefit plan was closed to employees hired after July 2003. Since then, new hires are enrolled in a tax-deferred contribution plan, similar in structure to the 401(K) Plan.

Q. Please explain the adjustments to the 401(K) Plan as shown on Sheet 9.

A. The 401(K) Plan was annualized by taking the payments for the Company's match for the 401(K) plan for the twelve months ended September 30, 2012, calculating the average monthly payment and multiplying by twelve. This results in an annual gross amount for 401(K) and then multiplied with the 67.09% O&M Expense Benefit Percentage which results in the amount to expense.

To project the 401(K) TME May 31, 2014 expense the amount was increased by the combined increase of the management compensation increase plus a 2% participation increase. Then, the 67.09% O&M Expense Benefit Percentage was applied to determine the TME May 31, 2014 expense.

Q. Please refer to Sheet 10 of Schedule 2 and explain the computation of the adjustment for the Dental Plan.

A. The premiums for the previous fiscal year were averaged and annualized to arrive at the gross amount, which is then multiplied by the 67.09% O&M Expense Benefit Percentage. I then projected increases through the TME May 31, 2014 using the appropriate inflation factor.

Q. Please describe your forecast for Long Term Disability into the TME May 31, 2014.

A. I have used the average premium payment and inflated it into the TME May 31, 2014. I then multiplied it with the O&M Expense Benefit Percentage to produce the TME May 31, 2014 expense.

Q. Please explain the adjustment that is made on Sheet 12.

A. I have analyzed Account 926 - Employee Benefits and have broken the account into the major benefit types in order to properly forecast the different benefit types. Other Benefits are the remaining benefit charges to Account 926.

Based upon previous Commission orders I have removed any amount in Other Benefits related to Stock Options, Stock Appreciation Rights and the Restricted Stock Plan. I then projected the credits on Products 2107, 2108, 2111 and 2161[2] for the loading of Sick and Other Approved Absences to labor dollars that are not expensed. This increases Other Benefits by $439,490. I then inflated the remaining Other Benefits by the inflation factor.

Q. Please describe your adjustment to Benefits from Other Jurisdictions as shown on Sheet 13.

A. Distribution borrows labor from other jurisdictions within the National Fuel Gas family. Mainly this labor is used to maintain lines in rural areas or near the Pennsylvania border. When an employee from National Fuel Gas Supply Corporation (Supply) or from the Pennsylvania Division of National Fuel Gas Distribution Corporation works on New York's lines, labor is charged to the New York Division. That labor is loaded with the benefits from the lending Company.

[2] The above mentioned Products are the products that load labor with benefits. This is the how the benefits are transferred from O&M to non-O&M accounts like plant.

Each Company has its own loading factor. I have applied the specific loading factor to the specific labor forecasted to be borrowed from Supply and the Pennsylvania Division during the TME May 31, 2014 to calculate the benefits related to that labor that would be the responsibility of the New York Division.

Q. Please describe how you forecast the amount for Low Income Customer Affordability Assistance Program (LICAAP).

A. The base rates designed as a result of Case 07-G-0141 provided the LICAAP customers with a $6,000,000 discount from the residential rates. This discount is composed of a rate discount, arrearage forgiveness and an administration component. The revenues for LICAAP included the rate discount for LICAAP ratepayers in the amount of $2,398,000. The remaining amount of $3,602,000 for arrearage forgiveness and administration is captured in O&M.

Q. Please describe the forecast for the PSC Assessment.

A. I have reflected the amount that was allowed in Case 07-G-0141 as all other amounts for the Temporary State Assessment are collected in a surcharge as ordered in Case 09-M-0311.

Q. Please explain the cost element Site Investigation and Remediation Costs (“SIR”) as shown on Exhibit___(RLT-1), Sheet 2.

A. I have reflected the amortization that was allowed in Case 07-G-0141.

Q. Please describe the calculation of the inflation factor.

A. As shown on Schedule 2, Sheet 14, I have developed an overall increase of 2.9307% by calculating the change from the TME May 31, 2014 averaged

forecasted quarters of the quarterly GDP Chained Price Index the average quarters TME September 30, 2012 of the quarterly GDP Chained Price Index. The annual rate base upon the overall increase of 2.9307% is 1.7483%. This is the method that Staff used in calculating the inflation factor in Case 07-G-0141.

Q. Where have you used the inflation rate to forecast expense in the TME May 31, 2014?

A. All elements of expense not already discussed has been inflated. The O&M components and the Other Taxes that were inflated are shown on Exhibit___(RLT-2), Sheet 15.

Q. Please explain the adjustment for FICA taxes on Schedule 2, Sheet 16 of Exhibit___(RLT-2).

A. I have calculated the FICA Tax for the TME May 31, 2014 payroll. I calculated the effective increase in TME May 31, 2014 gross payroll over the TME September 30, 2012 gross payroll and applied that increase to the historic gross FICA Tax. Then the gross FICA tax was multiplied by the O&M benefit percentage.

Q. Please explain the adjustment for Federal and State Unemployment Compensation on Sheet 17.

A. The earnings base for Federal and for State Unemployment was calculated and the appropriate rate was used to calculate the gross unemployment tax. The gross tax was then multiplied by the O&M benefit percentage.

Q. How have you forecast the remaining items of Taxes Other Than Income?

A. I have used the inflation factor to forecast an increase of these components to the TME May 31, 2014 as shown on Sheet 15.

Q. Is inflation appropriate for the forecast of property taxes when the trend has been decreasing for the Company?

Q. Yes. The Company has been quite aggressive in its efforts to minimize its property taxes. But it appears, however, that we have reached the maximum reduction in the property tax assessment and we anticipate that increases in tax rates from the individual taxing jurisdictions and increased assessment growth due to a continuing construction budget will more that outweigh property tax cost control that we have achieved with the obsolescence awards each year.

Distribution has applied for and received both functional and economic obsolescence adjustments from the New York State Office of Real Property Tax Services (NYSORPTS) for the last several years. Adjustments must be requested from the NYSORPTS. To the extent we can continue to demonstrate that the system suffers from functional obsolescence, the adjustments should continue.

<u>Obsolescence Award History</u>

2006	2%	Economic Obsolescence only
2007	6%	Economic Obsolescence only
2008	10%	Economic Obsolescence only
2009	16%	Functional Obsolescence only
2010	21%	Functional Obsolescence (16%) / Economic Obsolescence (5%)
2011	21%	Functional Obsolescence (16%) / Economic Obsolescence (5%)
2012	23%	Functional Obsolescence only

Previous functional obsolescence applications have only addressed medium pressure mains. This year our application will also include low pressure lines due to implementation of our new GIS system which allows the ability to optimize low pressure lines. However, NYSORPTS has indicated that obtaining additional adjustments may be difficult. At this time we are unable to predict whether NYSORPTS will recognize functional obsolescence of the low pressure system or what level of functional obsolescence will be recognized on the medium pressure system.

Q. You testified that the Company must apply each year for renewal of the obsolescence adjustment. Do you mean that the adjustment is subject to the approval of the NYORPTS every year?

A. Yes.

Q. What would happen if the adjustment were reduced or denied?

A. If the obsolescence adjustment is reduced or disappears, the impact would be significant. Further, unless the award increases over time the downward or even flattening of the property tax expense will be quickly overwhelmed by the Handy-Whitman Index (used by NYSORPTS to increase original cost plant to a replacement cost of plant) plus anticipated increases in the property tax rates.

Economic Obsolescence is the loss of value of property caused by an impairment in desirability or useful life resulting from factors external to the property. In the case of Distribution, economic obsolescence factors include, but

are not limited to, the economic climate of WNY (i.e. population losses, relatively poor income performance, shrinking natural gas consumption data, and etc.).

Functional Obsolescence is the impairment of operating capacity or efficiency resulting in the loss of value brought about by the failure of the tangible property to meet present or projected needs or where the capacity of the tangible property exceeds reasonable anticipated demands. In the case of Distribution functional obsolescence means the pipeline (diameter) is oversized for the anticipated demands of Distribution.

Obsolescence adjustments directly impact assessed valuations provided by NYSORPTS, all highway (special franchise property) and private property, for those jurisdictions at a 100% equalization rate (advisory appraisals). Economic obsolescence is applied to all of the Company's plant that is valued by NYSORPTS. Functional obsolescence is applied only to transmission and distribution mains only, which is approximately 95% of the total system.

Therefore, inflation applied to the TME September 30, 2012 level is an appropriate estimate of the increase anticipated with the flattening of any potential award by NYSORPTS and anticipated increases to the tax bills by the taxing jurisdiction.

Q. Do you have any indication that tax bills will be increasing when there is a 2% cap on property taxes in New York?

A. Yes. The Buffalo News ran an article on April 30, 2013, describing how the property tax cap excludes items such as pension payments and construction

projects. For many of our taxing jurisdictions, proposed increases are more than 2%, as stated in the article which is included in the workpapers for Schedule 2 of Exhibit___(RLT-2).

Q. How have you forecast Federal and State Income Taxes?

A. The Parent Company and Distribution are on a fiscal year of the TME September 30. This means that the tax returns for Federal and State Income Tax are filed using a September 30 tax year. Because this instant proceeding requires a detailed computation under time compressed conditions, I have chosen the ratemaking deductions taken during the TME September 30, 2012 and carried those deductions forward into the forecast for TME May 31, 2014.

The current ratemaking deductions at September 30 are at the most accurate and are matched correctly with the deferred taxes for those deductions. Also changes to the current deductions would cause similar changes to the deferred taxes and would not significantly change the overall Federal and State Income Taxes.

Q. But wouldn't the deferred taxes included in Rate Base change for changes to plant from September 30, 2012 to May 31, 2014?

A. Yes, they would and I have forecast them by taking the ratio of the change in net plant from the TME September 30, 2012 to the TME May 31, 2014 and applying it to the Deferred Income Taxes – Liberalized Depreciation TME September 30, 2012 balance to forecast the balance for the TME May 31, 2014.

Q. Would you explain the removal of the dollar amount for “Misc” on the Exhibit___(RLT-2), Schedule 3, Sheets 1?

A. For ratemaking purposes, the tax computation treats Distribution as a stand alone company and only includes deductions for ratemaking items, such as depreciation. Miscellaneous is a sum total of all deductions not included in ratemaking but included in the actual tax return. Because Distribution contains two jurisdictions – New York and Pennsylvania, deductions may be allocated for tax purposes differently than under a stand alone calculation, therefore Miscellaneous also contains the allocation differences. As the allocation differences and other deductions are not recognized for ratemaking purposes, I have removed them from the calculation of Federal and State Income Taxes for the TME May 31, 2014.

Q. Would you please explain why you changed the interest deduction?

A. Again, for ratemaking purposes, the interest deduction is not the actual interest paid during the TME September 30, 2012, nor is it the interest anticipated to be paid during the TME May 31,2014, but is calculated by multiplying the Rate Base by the weighted debt component of the overall return. This calculation is shown on Exhibit___(RLT-2), Schedule 3, Sheet 2.

Q. Please explain how you forecast Net Plant included in Rate Base?

A. Exhibit___(RLT-2), Schedule 4, Sheets 1 through Sheet 4 shows the estimated average net plant for the TME May 31, 2014. Sheet 1 shows the derivation of estimated average plant in service for TME May 31, 2014. I began with the actual

plant in service and actual reserve for depreciation at September 30, 2012. Based upon the Company's construction budget I estimated the monthly changes from October 2012 through May 31, 2014 to arrive at the projected average net plant. I have also included the Construction Completed Not Classified and the Non Interest Bearing Construction Work in Progress at September 30, 2012.

Sheet 2 shows similar calculations for estimated average reserve and shows the estimated average net plant at May 31, 2014.

Sheet 3 shows the Plant at September 30, 2012. Sheet 4 shows the construction budgets for TME September 30, 2013 and TME September 30, 2014.

Q. The Company is proceeding with the installation of a new Customer Information System and with the retirement of the mainframe and its associated systems which will be updated to non mainframe applications. Have you reflected these expenditures in your forecast of additions to Plant in Service?

A. To the extent that the application will be place in service during the TME May 31, 2014, the expenditure is included in Plant in Service. The new CIS system is scheduled to be placed in service during Fiscal 2017, which means that expenditures up until then will be held in Construction Work In Progress and accumulate AFUDC. Therefore those expenditures have been removed from the Plant In Service estimate.

Q. How was the Cash Allowance Working Capital calculated?

A. The cash working capital allowance for the TME May 31, 2014, is calculated by dividing total projected operations and maintenance expense, excluding

purchased gas, by eight. This is the FPC working capital methodology, the use of which has been insisted on by the Commission in prior cases.

Q. You have reflected an $23,530,000 addition to Rate Base for the Earnings Base In Excess of Capitalization (EB/Cap). Would you please explain the history of the adjustment and the rationale for the addition of $23,530,000 to Rate Base?

A. In the 1960's the preferred method of calculating the cash working capital[3] was the lead lag study. In the Consolidated Edison Case 25342 the Commission adopted the FPC method (1/8 of O&M) and stated:

> We agree with Staff and the Examiner, however, that the lag method of computing working capital has become so cumbersome as to make the time and expense of such a study disproportionate to whatever advantages the method may have in terms of accuracy. This is particularly true as applied to Con Ed rate cases…We further agree with Staff that we should use our decision in this case to discourage reliance upon the lag method in future cases. We do not, however, wish to lay down a blanket rule that the lag method may never be appropriate. Indeed, Staff recognizes that this method may be the best measure of telephone Company working capital requirements. What we do hold is that in future rate proceeding involving Consolidated Edison, we will direct our Staff to present FPC-type working capital studies; and the burden will be on the proponent of any "lag-method" working capital study to demonstrate affirmatively the superior accuracy of such a study as compared with the FPC-type analysis. In proceedings involving other companies, we will give careful consideration to FPC-type studies, and we will not utilize lag studies merely because such studies appear in the record.

In the mid 1970's the Commission became concerned that the FPC method was not precise and needed a new type of analysis that would modify

[3] Cash Working Capital historically has referred to the amount of cash needed on hand by the Company to pay its day to day operating expenses for the time period during which the Company has provided service and has not yet been fully paid for that service.

rate base to equal the amount of investment of the security holders, including short term investors, in the utility. And so the EB/Cap was born. The theory behind the EB/Cap is that in order that rates be set which are reasonable, a utility must be allowed to earn a fair return on the investment dedicated to public service. The investment, which is entitled to a fair return, is not the investment by the Company in assets dedicated to public service. Rather it is the investment by the holders of the capital of the Company, that is, the holders of the common equity and the debt of the Company, which includes short term investors. Because all investors require is an opportunity to earn a fair return on their investment, the rate base should be limited to that investment. If the utility was allowed to earn a return on a rate base which is greater than its capitalization, assuming the same rate of return, the equity return on the rate base would be greater than that allowed on the basis of capitalization.

Q. Has the Commission tied the use of the 1/8 O&M formula to the need for the EB/Cap adjustment?

A. Yes, it has. For example, in Consolidated Edison's 2009 rate case[4], the Commission stated:

> There is no risk to ratepayers of overpaying for cash working capital requirements if the FERC cash working capital formula and the EB Cap adjustment are both employed. For this reason, there is no need for the studies NYPA proposes. While it is true that it may be easier to prepare such studies now, compared to thirty or more years ago, there is no reason to believe there would be fewer disputes about the proper inputs to such studies. Given the

[4] Cases 08-E-0539; 08-M-0618, *Consolidated Edison Company of New York, Inc.,* Order Setting Electric Rates. April 24, 2009 at 312, 2009 N.Y. PUC LEXIS 507.

continued use of an EB cap adjustment, this could not provide any benefit to ratepayers.

Clearly, the Commission has determined that the EB/Cap must be used as a check on the FPC working capital formula because it has doubts as to the accuracy of the formula's results.

Q. Does the use of the EB/Cap make sense for Distribution?

A. No. As all of the elements of Distribution's rate base are specifically calculated based upon amounts included on Distribution's books, the only estimated item, the CWC must be the item that is causing the difference between the earnings base and the capitalization. The estimate of cash work capital along with the EB/Cap adjustment does not properly reflect the fact that Distribution is part of a Company that is regulated by two different jurisdictions, the NY PSC and the Pennsylvania Public Utilities Commission (PUC). Because of the two different jurisdictions, the capitalization of the total Company has been allocated based upon the determination of Distribution's total earnings base compared to the calculation of the total Company's earnings basis. This is not a proper allocation of capitalization due to the different ways items are treated by the two different commissions. For example, an item that is regularly included in rate base in NY is not allowed in rate base in Pennsylvania.

Q. How should this anomaly be handled in the ratemaking treatment for Distribution?

A. The cash working capital allowance should be calculated using the more precise and more specific to Distribution lead lag study.

Q. But hasn't the Commission prohibited the use of a lead lag study?

A. Apparently, it has, although for reasons that are not entirely clear to me. In Niagara Mohawk's 2010 rate case the Commission seemed to specifically prohibit the use of the lead lag in ratemaking for New York but with a qualification that seems no longer operable. The Commission stated that although "[w]e find that a working capital component related to commodity should be included in the merchant function charge. It is permissible to use a lead/lag study to determine this element of the charge" the Commission went on to say that "[o]ur decision here does not alter the standard practice that relies on the FERC formula to calculate the amount of working capital to be included in rate base." Nevertheless the Commission cautioned that "[l]ead/lag studies will not be accepted or used for rate base purposes as long as the FERC formula continues to be an acceptable and preferred approach." Cases 10-E-0050;08-E-0827, Niagara Mohawk Power Corp. d/b/a National Grid's Electric Business, Order Establishing Rates for Electric Service, 2011 N.Y. PUC LEXIS 19; 286 P.U.R.4th 401 (January 24, 2011).

Q. Does the Commission's refusal to recognize any means of determining working capital other than FERC's 1/8 O&M formula have a rational basis?

A. Not in my view, particularly when FERC, itself, has a more flexible approach to working capital and does not require the use of the formula.

Q. What is your understanding of FERC's position on the matter?

A. FERC is flexible on whether to use a lead-lag study or the 1/8 O&M formula. If there is a "reliable lead lag study," FERC will accept it and not insist on hewing to the formula.

> We deny AMP-Ohio's request to require PATH to perform a lead-lag study. In Trans-Elect NTD Path 15, LLC, the Administrative Law Judge held that long-established Commission policy provides that a company need not perform such a study, and may instead rely on the 45-day convention without further showing. We held that the Administrative Law Judge was "correct" in finding that the Commission's policy is that: "in the absence of a reliable lead-lag study approximating the utility's cash working capital needs or hardships that would justify departure from the established formula, a utility should use the 45 day convention." AMP-Ohio's protest in the initial proceeding did not make any assertion that there was a lead lag study available, or that the 45 day convention would produce unjust and unreasonable results.

Docket No. ER08-386-000, *Potomac-Appalachian Transmission Highline, L.L.C.,* 122 F.E.R.C. P61,188; 2008 FERC LEXIS 454 2008 FERC LEXIS 454 (February 29, 2008). Therefore, FERC's policy is now that a "reliable lag/lag study will obviate the use of the 1/8th O&M formula. It is, therefore, somewhat ironic that the Commission takes the view that the FERC formula must prevail in every instance when FERC, the originator of the formula (actually its predecessor the FPC) no longer insists on it.

Q. Why is the Commission's insistence on relying on this formula particularly troubling in the instant proceeding?

A. The Commission initiated this proceeding due to a erroneous calculation of earnings for Distribution for TME September 30, 2012. This calculation included the EB/Cap calculated for the same time period.

The EB/Cap used in setting rates in a litigated one year rate case – such as was Case 07-G-0141, is set at the historic year level and not forecast into the future – not even to reflect changes accepted by the Commission for the rate year. The rationale for this methodology, as I understand it, is that no forecast is necessary as for every dollar invested by the shareholders, the earnings base and the capitalization will change equally.

Q. Does that rationale hold in Distribution's situation?

A. No. Because Distribution is located in two regulatory jurisdictions, and the other jurisdiction does not calculate CWC in the same manner, inequities occur in the allocation of the capitalization, as explained earlier. For example, the difference between the FAS 106 and the rate allowance for OPEBs in the Pennsylvania Division is deferred. However, the deferral balance is not included in rate base nor does it accrue interest, therefore it is a stream of free cash. But for purposes of EB/Cap that deferral balance is treated in the calculation as if interest is accrued on the deferral balance or that balance is included in rate base for ratemaking purposes in Pennsylvania. This procedure allocated approximately 70% of the balance to the NY jurisdiction rather than reflecting it as 100% Pennsylvanian funds.

I have included as Sheet 5 and 6 a comparison of the EB/CAP from the one calculated in Case 07-G-0141 to the EB/CAP for the TME September 30, 2012.

Q. Has the EB/Cap adjustment has varied widely since the TME September 30, 2006 used in Case 07-G-0141?

A. Yes, it has. I have included the quarterly EB/CAP adjustments from TME September 30, 2006 to TME September 30, 2012 as Exhibit___(RLT-2), Schedule 4, Sheet 7. These adjustments are calculated quarterly for the twelve month period. I have also included on Sheet 8 a graph depicting these quarterly adjustments.

Q. Why is that?

A. Besides the problem with the jurisdictional inequities, part of the variance is due to changing gas prices over the time period. The open cycle of the "gas year" (TME August) is not included in the EB/Cap calculation – only the closed cycles. This creates a theoretical mismatch as the cash change is included in the calculation either in Short Term Debt or in Temporary Cash Investments but the reason that the cash has changed is not included because it is an open cycle.

Q. Have other NY utilities experienced changes in their EB/Cap calculations?

A. As shown on the Rate Plan Summaries in Mr. Meinl's Exhibit___(EHM-1), Schedule 2, all of the companies' EB/CAP calculations have shown great variability over the past couple of years. The two highest swings were experienced by National Grid – KEDNY and Consolidated Edison. National

Grid–KEDNY's EB/Cap went from 5.1% of Rate Base to 1%. Consolidated Edison's EB/Cap went from a 3% of Rate Base to 0.2%.

A variance in the calculation of the EB/Cap in this magnitude discredits the basis of the hypothesis mentioned earlier – that for every dollar invested, the Earnings Base and the Capitalization changes equally. For the Commission to base its conclusion that Distribution's earnings must be investigated and remedied when the EB/Cap hypothetical ratemaking adjustment is one of the few reasons for "over earning" is therefore, highly suspect.

Q. Have you requested that the Commission change the methodology for the EB/Cap calculation in the past to rectify these distortions?

A. Yes, I have testified in previous rate cases that the methodology should be changed and have been denied each time. That does not change my conviction that this ratemaking construct is flawed and not representative of Distribution's cash working position. Distribution's cash working position should be calculated using a lead lag methodology.

Q. Have you forecast the average balance for Site Investigation & Remediation for the TME May 31, 2014?

A. Yes and it is shown on Sheet 9 of Exhibit___(RLT-2), Schedule 4. I have used the current amortization and an estimate of expenditures for ongoing remediation and incremental remediation for a site that the Department of Environmental Protection has issued a Recommended Order of Decision. Remediation (after a design phase) is expected to begin in February 2014.

Q. The Commission seems troubled by potentially growing deferrals. Do you understand this concern?

A. No, I don't. If the Commission were truly concerned about the growing deferrals which represent monies owed to the Company by the ratepayers, the Commission could have accepted the Company's proposal and direct that the ratepayer's share of any overearnings be used to reduce the deferral balances.

Q. Does this conclude your testimony?

A. Yes, it does.