

BEFORE THE STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

ORIGINAL	
N.H.P.U.C. Case No.	DG 11-040
Exhibit No.	#10
Witness	Scott J. Rubin
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In the matter of:

National Grid USA, National Grid NE Holdings 2)
LLC, Granite State Electric Company d/b/a National)
Grid, EnergyNorth Natural Gas, Inc. d/b/a National)
Grid NH, and Liberty Energy Utilities Co. and Liberty)
Energy Utilities (New Hampshire) Corp.)
)
)
Docket No. DG 11-040)

Direct Prefiled Testimony

of

Scott J. Rubin
On behalf of the Office of the Consumer Advocate

Dated: October 7, 2011

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Attachment SJR-2	Liberty budget slides from Sept. 7-8, 2011
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1 **Introduction**

2 **Q. Please state your name and business address.**

3 A. My name is Scott J. Rubin. My business address is 333 Oak Lane, Bloomsburg, PA.

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

5 A. I am an independent consultant and an attorney. My practice is limited to matters
6 affecting the public utility industry.

7 **Q. What is the purpose of your testimony in this case?**

8 A. I have been asked by the New Hampshire Office of the Consumer Advocate (“OCA”) to
9 help the OCA evaluate the proposed acquisition by Liberty Energy Utilities (New
10 Hampshire) Corp. (“Liberty”) of two New Hampshire utilities owned by National Grid
11 USA (“National Grid”): Granite State Electric Co. (“Granite State”) and EnergyNorth
12 Natural Gas, Inc. (“EnergyNorth”). I will refer to National Grid and Liberty collectively
13 as “Joint Petitioners.”

14 **Q. What are your qualifications to provide this testimony in this case?**

15 A. I have testified as an expert witness before utility commissions or courts in the District of
16 Columbia, the province of Nova Scotia, and in the states of Arizona, California,
17 Connecticut, Delaware, Kentucky, Illinois, Maine, Maryland, New Hampshire, New
18 Jersey, New York, Ohio, Pennsylvania, and West Virginia. I also have testified as an
19 expert witness before two committees of the U.S. House of Representatives and one
20 committee of the Pennsylvania House of Representatives. I also have served as a

1 consultant to the staffs of the Connecticut Department of Public Utility Control and the
2 Delaware Public Service Commission, as well as to several national utility trade
3 associations, and state and local governments throughout the country. Prior to
4 establishing my own consulting and law practice, I was employed by the Pennsylvania
5 Office of Consumer Advocate from 1983 through January 1994 in increasingly
6 responsible positions. From 1990 until I left state government, I was one of two senior
7 attorneys in that Office. Among my other responsibilities in that position, I had a major
8 role in setting that Office's policy positions on water and electric matters. In addition, I
9 was responsible for supervising the technical staff of that Office. I also testified as an
10 expert witness for that Office on rate design and cost of service issues.

11 Throughout my career, I developed substantial expertise in matters relating to the
12 economic regulation of public utilities. I have published articles, contributed to books,
13 written speeches, and delivered numerous presentations, on both the national and state
14 level, relating to regulatory issues. I have attended numerous continuing education
15 courses involving the utility industry. I also periodically participate as a faculty member
16 in utility-related educational programs for the Institute for Public Utilities at Michigan
17 State University, the American Water Works Association, and the Pennsylvania Bar
18 Institute. Attachment SJR-1 to this testimony is my curriculum vitae.

19 **Q. Do you have any experience that is particularly relevant to the issues in this case?**

20 A. Yes, I do. I have substantial experience in cases involving the proposed acquisition of a
21 public utility. During my career, I have performed legal or consulting services for public

1 advocates, consumer groups, or labor unions in approximately 20 cases involving
2 proposed utility mergers, acquisitions, or spin-offs, including the following:

- 3 • Allegheny Energy proposed acquisition of Duquesne Light Company
- 4 • Alltel spinoff to create Windstream
- 5 • Centerior – GPU merger to create FirstEnergy
- 6 • CenturyLink acquisition of Qwest
- 7 • CenturyTel merger with Embarq to create CenturyLink
- 8 • Dominion Resources sale of Peoples Natural Gas Co. to Steel River
- 9 • Duke Energy acquisition of Cinergy
- 10 • Exelon proposed acquisition of PSE&G
- 11 • FairPoint acquisition of Verizon New England
- 12 • FirstEnergy proposed acquisition of Allegheny Energy
- 13 • Frontier acquisition of Verizon operations in 14 states
- 14 • Long Island Lighting Co. break-up (sale of gas operations to Brooklyn
15 Union Gas; sale of electric operations to Long Island Power Authority)
- 16 • Macquarie acquisition of Duquesne Light
- 17 • Pennichuck Corp. proposed sale to City of Nashua
- 18 • PSC Corp. acquisition of Consumers Water
- 19 • RWE acquisition of American Water Works Co.
- 20 • RWE divestiture of American Water Works Co.
- 21 • SBC acquisition of AT&T
- 22 • Sprint spinoff to create Embarq
- 23 • United Water proposed acquisition of Pennsylvania Gas & Water Co.
- 24 • Verizon acquisition of MCI

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Summary

Q. Please summarize your recommendations and conclusions.

A. I summarize my conclusions and recommendations as follows:

- Liberty has not demonstrated that it has the requisite financial, technical, and managerial fitness to own and operate EnergyNorth and Granite State.
- Liberty has not provided the covenants, interest rate, or other terms and conditions of the new debt it seeks to assign to EnergyNorth and Granite State. It is not possible, therefore, to determine whether it is consistent with the public good for these New Hampshire utilities to become obligated to that debt.
- Liberty’s operating costs, and therefore the rates it would need to charge to customers, would be higher than the costs EnergyNorth and Granite State would incur if they remained part of National Grid.
- Liberty is not proposing to make any significant improvements in the quality of service received by customers.
- The customers of EnergyNorth and Granite State will suffer a net harm if the proposed transaction is approved. Consequently, it would not be consistent with the public good to approve the transaction.
- I do not find a compelling reason for the proposed transaction to occur. If the Commission believes that there are reasons to approve the proposed transaction, however, I offer a series of conditions that would help protect the utilities’ customers from some of the adverse effects of the proposed transaction. I cannot be certain that these conditions would eliminate all of the potential harm from the transaction, but they would at least provide some measure of protection.
- Notwithstanding these proposed conditions, my primary recommendation is that the Commission should reject the proposed transaction because it would result in net harm to the customers of these New Hampshire utilities.

The Proposed Acquisition

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Q. What is your understanding of the proposed transaction?

A. National Grid and Liberty entered into two stock purchase agreements, one dealing with each utility. The Granite State agreement is labeled “Joint Petitioners Attachment 3” as part of their original filing. That agreement provides that Liberty will purchase all of the common stock of Granite State for approximately \$83 million. Joint Petitioners Attachment 3, p. 17. The EnergyNorth agreement is labeled “Joint Petitioners Attachment 4.” That agreement provides that Liberty will purchase all of the common stock of EnergyNorth for approximately \$202 million. Joint Petitioners Attachment 4, p. 19. Following the consummation of the Stock Transfers, Granite State and EnergyNorth will each become wholly-owned subsidiaries of Liberty and will continue to provide electric and natural gas service, respectively, to New Hampshire customers. Joint Petition, p. 2.

In addition to the transfer of stock, the agreements also contemplate that National Grid will need to continue to provide certain services for Liberty after closing under Transition Services Agreements (TSAs). Under the TSAs, National Grid, either directly or through its affiliates, will provide various services to Granite State, EnergyNorth, and Liberty following the consummation of the Stock Transfers until such time as Granite State, EnergyNorth and/or Liberty notifies National Grid that one or more of the services provided under its respective TSA are no longer needed. Joint Petition, p. 7.

Also, Liberty intends to finance its acquisition of Granite State and EnergyNorth in part with new debt issued by these utilities. Joint Petition, p. 13. Specifically, Liberty

1 seeks approval for Granite State to issue a promissory note to Liberty Energy NH for up
2 to \$20 million and for EnergyNorth to issue a promissory note to Liberty Energy NH for
3 up to \$85 million to support debt financing to be undertaken by Liberty Energy NH.
4 Joint Petition, p. 13.

5 **Q. What is your understanding of the ultimate questions before the Commission in this**
6 **proceeding?**

7 A. My understanding is based upon advice of counsel and is summarized as follows. The
8 Joint Petitioners seek approval of the proposed stock transfer pursuant to RSA 374:30
9 and RSA 374:33 and approval of the proposed financing requests pursuant to RSA 369.
10 RSA 374:30 authorizes the transfer of a utility franchise, works or system only if the
11 Commission finds “that it will be for the public good.” RSA 374:33 authorizes the
12 transfer of 10 percent or more of stock in certain electric and gas utilities only if the
13 Commission “finds that such acquisition is lawful, proper and in the public interest.”
14 RSA 369:1 and RSA 369:4 authorizes the Commission to approve public utility long
15 term debt only if it “is consistent with the public good.”

16 In determining whether proposed financing is consistent with the public good, the
17 Commission is required “to consider the amount of the issue authorized, the purpose or
18 purposes for which the proceeds are to be used, and the reasonableness of the terms and
19 conditions of the financing.” *Public Service Company of New Hampshire, Inc.*, DE 10-
20 122, Order No. 25,178 (December 17, 2010), slip op. at 19, *citing Appeal of Easton*, 125
21 N.H. 205, 211-213 (1984). In addition, according to the New Hampshire Supreme Court,

1 the Commission must consider factors beyond the purpose and terms of the proposed
2 borrowing. Id. This additional analysis includes consideration of the effect on rates. Id.

3 Within the context of an acquisition, the Commission, in making its “public
4 interest” or “public good” determination, considers whether the acquirer has the financial,
5 managerial and technical abilities to operate the utility. *See, e.g., Verizon New England,*
6 *Inc.*, 93 N.H. P.U.C. 24 (2008). The Commission may also consider the effects of the
7 transaction. Id. at 63 (“In considering major utility transactions, our public interest
8 determination is not wholly dependent on a positive decision on the question of financial,
9 managerial and technical capacity. These capabilities are necessary but may not be
10 sufficient. We must also undertake a broader assessment of the effects of the
11 transaction.”). The Commission approaches acquisitions of public utilities with a
12 “holistic” inquiry of the circumstances. Id.

13 The Commission has not made it clear whether the “public interest” or “for the
14 public good” standard requires only “no net harm” to the public, or the application of a
15 more stringent standard that the transaction should produce a “net benefit” to the public.
16 For example, in *Merrimack County Telephone Co.*, 87 N.H. P.U.C. 278, 282 (2002), the
17 Commission stated: “In verifying the assertion made by the Parties at the hearing that
18 there are no adverse effects, or no net harm associated with the transaction, we also
19 inquired as to whether the acquisition provides net benefits to consumers.” *See also*
20 *National Grid plc*, 92 N.H. P.U.C. 279, 319 (2007) (noting that a variety of statutes
21 applied and complex issues were being resolved, the Commission “consider[ed] all the
22 interests involved and all the circumstances in determining what is reasonable”) and

1 *Verizon New England Inc.*, 93 N.H. P.U.C. 24, 63 (2008) (“we need not decide here
2 whether to apply a ‘net benefits’ or ‘no net harm’ approach”).

3 **Q. Have you formed an opinion as to whether the proposed transaction would be for**
4 **the public good?**

5 A. Yes, I have.

6 **Q. What are you relying on to reach that opinion?**

7 A. As detailed throughout my testimony, I am relying primarily on statements and analyses
8 provided by Joint Petitioners as presented in testimony and responses to numerous data
9 requests. I have limited my review of data responses to those that the Joint Petitioners
10 provided up to and including September 30, 2011, which was the original due date for
11 this testimony. If Joint Petitioners provide additional information after that date, I may
12 address it in later oral or written testimony, as the procedural schedule permits.

13 **Q. How do you evaluate whether a proposed stock transaction is in the public interest?**

14 A. Consistent with Commission practice, I attempted to evaluate the financial, managerial
15 and technical capabilities of Liberty. Also, to assess the effects of the proposed stock
16 transaction, I evaluated three additional factors to determine whether a proposed stock
17 transaction is in the public interest: (1) effect on the utility’s cost of service and rates; (2)
18 effect on the utility’s quality of service; and (3) effect on the State’s economy. My
19 consideration of the effects of the proposed transaction on the State’s economy “is
20 limited to observing, as [a factor] in the overall calculus of determining whether the

1 transaction should be approved, whether the transaction provides other benefits which
2 serve the public interest.” *See Verizon New England Inc.*, 93 N.H. P.U.C. at 68.

3 **Q. Have you evaluated those factors for this proposed transaction?**

4 A. Yes, I have evaluated all of these factors to the extent that Joint Petitioners have provided
5 information or made claims about them in this case.

6 **Q. Based on your evaluation of those factors, in your opinion is the transaction as
7 proposed likely to lead to “net benefits” to the public?**

8 A. No. The statements and data produced by Joint Petitioners do not provide any indication
9 that customers will be any better off if Liberty owns Granite State and EnergyNorth than
10 they would be if National Grid continued to own the utilities.

11 **Q. Based on your evaluation of those factors, in your opinion is the transaction as
12 proposed likely to cause a net harm to the public?**

13 A. Yes. As I explain below, the data provided by Liberty show that the cost of service (and
14 thus the rates paid by customers) at each utility would be higher under Liberty ownership
15 than it would be under National Grid ownership. I do not find that the Joint Petitioners
16 propose any enhancements to service or other improvements that would offset the
17 substantial harm to the public that would be caused by Liberty’s higher operating costs.
18 Further, I find that there is insufficient information to draw any conclusions about the
19 effect of the proposed transaction on the state’s economy or about whether Liberty

1 possesses the requisite financial, managerial and technical abilities to own EnergyNorth
2 and Granite State.

3 **Financial, Managerial, and Technical Fitness of Liberty**

4 **Q. Have you attempted to evaluate the financial, managerial, and technical fitness of**
5 **Liberty?**

6 A. Yes, I have attempted to determine whether Liberty has the requisite technical, financial,
7 and managerial fitness to own and operate a natural gas utility and an electric distribution
8 utility. In my opinion, this remains an open question.

9 First, as of the last week in September – almost 10 months after the transaction
10 was announced – Liberty still has not obtained financing for the transaction. Without
11 actual information about the financing for the transaction – including not only the interest
12 rate and the terms, conditions, and covenants lenders will require – it is not possible to
13 know whether Liberty will have the financial capability to reliably operate and capitalize
14 the utilities.

15 Second, Liberty has no experience owning and operating a natural gas utility.
16 While Liberty has been hiring personnel with gas operations experience, it remains
17 unknown whether Liberty will have the required management, operational, engineering,
18 and technical expertise to reliably operate and maintain a natural gas utility.

19 Owning and operating a natural gas utility is about more than hiring a few people
20 with specialized expertise. The very management and culture of a natural gas utility must
21 be fundamentally different than that of other utility services. Natural gas service is

1 fundamentally different from other fixed utility services because of the serious risk to the
2 public from leaks or equipment malfunctions. Simply stated, there is an exceedingly low
3 tolerance for natural gas outages and losses. While losses of 15% or more and periodic
4 outages (due to main breaks, for example) are common for water utilities (where much of
5 Liberty's experience lies), losses or outages of that magnitude would be intolerable and
6 potentially disastrous for a natural gas utility. Typically gas losses should be only about
7 1% and outages should be extremely rare. Indeed each time there is a gas outage, the
8 utility must take extraordinary measures to ensure the safety of its customers, the general
9 public and gas workers – turning off the gas separately to each home or business, then
10 when service is restarted, visiting each home or business again to restart service, light
11 pilot lights, and so on. In short, managing a natural gas network is not like managing
12 other utilities. Liberty's management does not have any experience managing a gas
13 network, so I cannot evaluate its fitness to do so.

14 **Q. What do you conclude about Liberty's technical, financial, and managerial fitness to**
15 **own and operate EnergyNorth and Granite State?**

16 A. I conclude that I cannot render an opinion about Liberty's fitness to own and operate
17 these utilities in New Hampshire. Liberty has not obtained financing for the transaction
18 and does not have any experience owning or operating a natural gas utility. There are too
19 many unknowns about Liberty's financial condition and expertise for me to draw any
20 conclusions about Liberty's fitness.

Proposed Debt Financing

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Q. Does the proposed transaction include new debt obligations for EnergyNorth and Granite State?

A. Yes. The Joint Petition requested Commission approval for Granite State to issue a promissory note to Liberty Energy NH for up to \$20 million and for EnergyNorth to issue a promissory note to Liberty Energy NH for up to \$85 million to support debt financing to be undertaken by Liberty Energy NH. Joint Petition, p. 13. At a technical conference on September 7-8, 2011, Liberty provided an estimate of the debt that would be assigned to each utility. Those figures do not match the request it made in the Joint Petition; in fact, the estimated level of debt at EnergyNorth would exceed the \$20 million upper limit that Liberty requested in its Joint Petition. I will leave it for counsel to address the legal effects, if any, of this change on the Commission’s ability to rule on the Joint Petition as filed.

Q. Have you been able to determine whether the proposed debt financing is consistent with the public good?

A. No, I have not. Even though this transaction was announced nearly 10 months ago, Liberty has not yet obtained the debt financing it needs to close the transaction. As I am preparing this testimony in the first week of October, Liberty has not provided the financing documents, commitment letters, covenants, interest rates, or other terms and conditions of that financing. Without seeing the actual financing documents (or at least a commitment letter that sets forth in detail the interest rates, covenants, and other terms

1 and conditions), it is not possible to determine whether it is consistent with the public
2 good for the utilities to undertake these substantial debt obligations.

3 **Q. What do you recommend?**

4 A. I recommend that the Commission reject Liberty's request to approve the issuance of
5 more than \$100 million in new utility debt because of Liberty's failure to provide any
6 information about the proposed debt's terms and conditions.

7 **Effect of Proposed Transaction on Cost of Service**

8 ***Increased Operating Costs***

9 **Q. Has Liberty provided information showing how its operating costs would compare**
10 **to National Grid's cost of operating Granite State and EnergyNorth?**

11 A. Yes, at the technical conference on September 7-8, 2011, and in subsequent data request
12 responses, Liberty provided information about its projected operating costs as compared
13 to National Grid's costs. Attachment SJR-2 contains the budgeting slides from the
14 presentation that Liberty provided at the technical conference (slides 13-26 of the
15 presentation slide deck).

16 Liberty's analysis shows that it would require more employees and a higher level
17 of expenses to provide the same service that National Grid is providing today.

18 Specifically, on slides 22-23, Liberty shows that its cost of service would be \$889,000
19 more than National Grid's cost of service at Granite State and \$876,000 more than
20 National Grid's costs at EnergyNorth.

1 Further information provided by Liberty shows that these figures under-estimate
2 the cost difference. First, in its response to OCA Tech 2-1 (Attachment SJR-3), Liberty
3 shows that it understated the budget at Granite State by \$74,000. Therefore, Liberty's
4 cost to operate Granite State would be \$963,000 more than the costs under National
5 Grid's ownership.

6 Second, Liberty's cost estimates include estimated labor cost savings of \$772,000
7 in the information technology ("IT") department, as shown in Attachment SJR-2 on slide
8 26. Those labor cost savings are offset, however, by increased non-labor IT costs.
9 Specifically, slide 26 in Attachment SJR-2 shows non-labor IT costs would be \$143,000
10 higher under Liberty than under National Grid. But an examination of how those costs
11 are developed (Attachment SJR-2, slide 25) shows that Liberty failed to include any
12 return on its significant IT capital investment. While slide 25 includes depreciation on
13 that capital investment (return *of* capital), there is no entry for return *on* that capital
14 investment. Slide 24 in Attachment SJR-2 shows the amount invested would be in excess
15 of \$6.3 million. Without debating the appropriate rate of return, it is likely that the pre-
16 tax return on a \$6 million investment would amount to at least \$600,000.

17 In other words, Liberty's projected savings in IT labor costs (that are included in
18 its budget) would be almost completely offset by increased costs for IT operations,
19 maintenance, depreciation, and return on investment. It appears, therefore, that it would
20 cost Liberty on the order of \$2.5 million more to operate EnergyNorth and Granite State
21 than it would cost if National Grid remained the owner of those utilities. That \$2.5
22 million consists of the following:

Increased costs at Granite State	\$ 963,000
Increase costs at EnergyNorth	876,000
IT non-labor cost increase	143,000
Return on IT investment (minimum estimate)	600,000
Liberty cost increase compared to National Grid	<u>\$2,582,000</u>

1 ***Other Cost Increases***

2 **Q. Does the above listing capture all of the cost changes that are likely under Liberty’s**
3 **ownership?**

4 A. No, it does not. Liberty indicated during the September 2011 technical conference that
5 its operating expense and capital expenditure estimates did not include office furnishings
6 (furniture, computers, etc.) for the new New Hampshire facilities and additional
7 employees it projects. Those expenditures would push the cost differential even higher.
8 Liberty subsequently provided an estimate that it would need to incur approximately
9 \$400,000 in capital expenditures to equip these offices. Liberty response to Staff TS
10 2-18, attached as Attachment SJR-4.

11 ***Debt Costs***

12 **Q. Are there any cost savings that could offset some or all of these cost increases under**
13 **Liberty’s ownership?**

14 A. Yes. Offsetting some of that increased cost might be savings from Liberty’s projection
15 that it would refinance the utilities’ debt. Liberty, however, has not quantified this
16 potential savings. Also, I have serious concerns with recognizing it as a cost savings
17 from the transaction because National Grid also may have the ability to refinance the
18 utilities’ debt to take advantage of some of the lowest interest rates in the past 50 years.

1 Thus, I have not reflected any debt-cost savings as a benefit of the transaction because I
2 would expect prudent utility management under National Grid (or any other owner) to
3 attempt to achieve similar debt-cost savings.

4 Moreover, even if I did recognize the savings from refinancing debt, Liberty's
5 September 2011 technical conference presentation (slide 30, attached as Attachment
6 SJR-5) shows that there would be a total of \$100 million in new debt at the two utilities.¹
7 Liberty suggested at the technical conference that it might be able to procure that debt at
8 an interest cost that is approximately 150 to 175 basis points lower than the utilities'
9 current embedded cost of debt. If that were to occur, then the savings would amount to
10 \$1.5 million to \$1.75 million per year, which still is not enough to offset the cost increase
11 in operating and IT-related costs. In addition, those estimates were only provided orally
12 at a recent technical conference and have not been substantiated by the Company. As I
13 noted earlier, we are nearly 10 months after the transaction was announced and Liberty
14 still does not have financing in place for the transaction.

15 ***Tax Impacts***

16 **Q. Would the proposed transaction have other effects on the utilities' rates?**

17 A. Yes, National Grid and Liberty have agreed to make an election under Section 338(h)(10)
18 of the Internal Revenue Code for Granite State. Joint Petitioners Attachment 3, pp. 15-

¹ The debt levels at each utility contained in Attachment SJR-5 do not match the request Liberty made in the Joint Petition. Specifically, the Joint Petition requested permission to issue up to \$20 million in new debt by EnergyNorth (Joint Petition, p. 13. Liberty is now projecting that EnergyNorth would incur as much as \$23 million in new debt in order to finance the transaction. I will leave it for counsel to address the legal effects, if any, of this change on the Commission's ability to rule on the Joint Petition as filed.

1 17. Although not mentioned in the Joint Petitioners' petition or testimony, there could be
2 a substantial ratemaking impact associated with this election.

3 **Q. What is a Section 338(h)(10) election?**

4 A. I am not an expert on taxation, but I think I can accurately summarize the effect of such
5 an election. This provision of the Internal Revenue Code allows an entity purchasing the
6 stock of a corporation to treat the transaction for tax purposes as if it purchased the assets
7 of the acquired company. When assets are purchased, the current owner of the acquired
8 company must recognize a capital gain on the difference between tax basis of the assets
9 and the purchase price. The acquiring company is then permitted to recognize the full
10 purchase price as its tax basis in the property.

11 For a regulated public utility, there is an important implication of a Section
12 338(h)(10) election: the utility's deferred tax balance disappears. In effect, that deferred
13 tax liability is satisfied by restating the value of the assets and recognizing the capital
14 gain.

15 As the Commission is well aware, deferred tax balances are treated as a deduction
16 from rate base in a rate case. The rate base deduction recognizes that the utility's rates
17 have been set using traditional ratemaking methods (the most important of which is the
18 use of a book depreciation method) while the utility's income taxes are calculated using
19 different rules (particularly accelerated depreciation). The difference between book
20 accounting and tax accounting creates a deferred tax liability – taxes are lower in the
21 early years of an asset's life and greater in the later years of the asset's life. For

1 ratemaking purposes the tax payments are normalized, and the Internal Revenue Code
2 contains very specific rules governing how public utilities can normalize tax payments
3 for ratemaking purposes.

4 There is a concern that these normalization rules could be violated if the utility
5 continues to recognize deferred tax balances for ratemaking purposes after a Section
6 338(h)(10) election is made because those balances no longer exist for tax purposes. If
7 normalization rules are violated, then the utility can lose the ability to use accelerated
8 depreciation for tax purposes. As I said earlier, I am not a tax expert, and I cannot
9 explain the intricacies of normalization; but I am aware that great care must be taken in
10 how the effect of a Section 338(h)(10) election is reflected for ratemaking purposes.

11 **Q. If the Commission were to approve the petition as filed by Joint Petitioners, what**
12 **would be the effect?**

13 A. If the Commission were to approve the petition as filed, I believe that Granite State's
14 deferred income tax balances would be lost for ratemaking purposes. The result would
15 be a substantial increase in Granite State's rate base, which would lead to an increase in
16 rates.

17 **Q. Are there ways to avoid this result?**

18 A. Yes. It is my understanding that the Commission can create a regulatory liability that is
19 equivalent to the deferred tax liability and direct the utility to reflect that liability through
20 rates in a manner that mirrors the treatment of accumulated deferred taxes.

1 **Q. Has the Commission dealt with the effects of a Section 338(h)(10) election in any**
2 **other cases?**

3 A. Yes, I am advised by counsel that in 2008 the Commission approved a settlement
4 involving the acquisition of Northern Utilities, Inc., by Unitil Corp. One of the
5 settlement provisions approved by the Commission states as follows:

6 Accumulated Deferred Income Tax: In regard to Unitil's Section
7 338(h)(10) election in accounting for the acquisition of the common stock
8 of Northern, Unitil commits to hold Northern's customers harmless for the
9 elimination of the historical accumulated deferred income tax (ADIT)
10 liabilities resulting from such election by maintaining pro-forma
11 accounting for regulatory purposes to continue to provide ratepayers with
12 the ratemaking benefit of Northern's ADIT balances existing prior to the
13 proposed transaction, until such time as Northern's actual ADIT, related to
14 the historical utility plant assets acquired, equals or exceeds the level that
15 Northern's pro-forma ADIT would have been absent the proposed
16 transaction. The ADIT balances related to capital additions after the
17 closing date are not affected by the Section 338(h)(10) election and the
18 treatment of these balances will not change for accounting and ratemaking
19 purposes.

20 *Unitil Corporation*, 93 N.H. P.U.C. 502, 513-514 (2008).

21 **Q. You mentioned earlier that the Section 338(h)(10) election was not mentioned in**
22 **Joint Petitioners' petition or testimony. What was the Joint Petitioners' original**
23 **position on the regulatory accounting effect of the proposed transaction?**

24 A. The Joint Petitioners originally stated that no regulatory accounting changes would be
25 required as a result of the transaction (Eichler testimony, p. 10) and that the transaction
26 would have no effect on either utility's rate base (response to Staff 2-73).

1 **Q. Have Joint Petitioners subsequently explained their position on this issue?**

2 A. Yes, in response to OCA 2-10 (attached as Attachment SJR-6), Joint Petitioners explain
3 their position regarding the Section 338(h)(10) election for Granite State. While I cannot
4 speak for Joint Petitioners, my reading of this response is that they recognize the concern
5 and appear willing to address any ratemaking impacts of the election.

6 **Q. What do you conclude about the effects of the Section 338(h)(10) election for**
7 **Granite State?**

8 A. If the petition is approved as filed, there would be a substantial harm to Granite State's
9 customers. If language similar to that adopted in the Unutil-Northern case is contained in
10 an order approving this transaction, then there would be no harm (and no benefit) to
11 customers from this one aspect of the proposed transaction.

12 ***Cost of Service Effect Conclusion***

13 **Q. What do you conclude about the effect on the public good of Liberty's cost of**
14 **operating the utilities?**

15 A. I conclude that it appears highly likely that Liberty's cost to operate the utilities will be
16 higher than the costs that the utilities would incur under National Grid's ownership.
17 Indeed, there is the strong potential for utility rates to increase by millions of dollars
18 solely because of the change of the owner of the utilities' common stock. If those
19 increased costs are recognized in the rates paid by customers of EnergyNorth and Granite
20 State, this would constitute a net harm to customers and to the public.

1 **Effect of Proposed Transaction on Service Quality**

2 **Q. Has Liberty made any statements, or provided any information, indicating that it**
3 **plans to improve the quality of service provided by Granite State and EnergyNorth?**

4 A. No. As far as I can tell, Liberty plans to try to maintain the existing level and quality of
5 service that is provided to customers of Granite State and EnergyNorth. I have not seen
6 any statements to indicate that Liberty has specific plans to improve service quality at
7 either utility. For example, in response to Staff 4-58 (attached as Attachment SJR-7),
8 Liberty states that its telephone service level targets would be answering 80% of calls to
9 EnergyNorth in 30 seconds and 80% of calls to Granite State in 20 seconds. These are
10 the same standards that exist today for the utilities under National Grid’s ownership.
11 That same response indicates that Liberty does not intend to adopt any other specific
12 customer-service performance levels.

13 **Q. Do you have reason to doubt Liberty’s ability to maintain existing levels of service**
14 **quality?**

15 A. I do not doubt Liberty’s intention to maintain existing levels of service quality, at least
16 over the long run. I am very concerned, however, about the effects on service quality of
17 Liberty’s transition from National Grid’s call centers and operating systems to Liberty’s
18 call center and operating systems. As this Commission knows from recent experience
19 with a telecommunications utility, the transition from one set of systems and processes to
20 another can be quite problematic. I sincerely hope that Liberty does not experience such
21 problems, but it would be ill-advised for the Commission to not recognize the risk that
22 such problems could occur.

1 **Q. What does this mean for your analysis of service quality as it relates to the public**
2 **good?**

3 A. It appears likely that Liberty’s acquisition of the utilities would result in no net harm and
4 no benefit to the public, as it relates to service quality. I recognize, however, that there
5 could be transition problems that would harm the public. I conclude, therefore, that there
6 are no service-quality benefits from the proposed transaction that would even partially
7 offset the increased costs that Liberty would incur to operate the utilities.

8 **Effect of Proposed Transaction on the State’s Economy**

9 **Q. Have Joint Applicants provided any information about the effect of the proposed**
10 **transaction on the state’s economy?**

11 A. No, they have not. Liberty states that it will employ more people in New Hampshire than
12 National Grid employs, but it is unclear whether that would have much if any impact on
13 the state’s economy. It appears that most of the “new” employees would be existing
14 National Grid employees who currently work in Massachusetts. It is unknown where
15 those people live and shop now, or where they would live and shop after the transfer. For
16 example, if most of them currently live and shop in New Hampshire and commute to
17 Massachusetts for work, it would have a very small impact (if any) on the state’s
18 economy to move their job location to New Hampshire. By the same token, if someone
19 currently lives and works in Massachusetts and plans to continue living in Massachusetts
20 after the job is moved to New Hampshire, it also would have a very small impact (if any)
21 on the state’s economy.

1 Simply stated, Joint Petitioners have not provided any analysis of economic
2 impact on the state’s economy or any information about whether such an impact even
3 would be measurable. What we do know is that Liberty will not be as efficient an
4 operator as National Grid; it will cost Liberty more to provide the “back office” functions
5 (e.g., call center, billing, customer service, and so on) to Granite State and EnergyNorth
6 than it costs National Grid to provide those services to the New Hampshire utilities. As I
7 discussed above, that increased cost appears to be in the millions of dollars per year. It
8 would take a substantial positive impact to the state’s economy to offset the negative
9 economic impact from customers being required to pay millions of dollars per year more
10 to Liberty than they pay to National Grid. Joint Petitioners have not provided any claims
11 or documentation that such an offsetting benefit would exist if the proposed transaction is
12 approved.

13 **Q. What do you conclude about the effects on the state’s economy as they relate to the**
14 **public good?**

15 A. I conclude that there is no indication that there would be a benefit to the state’s economy
16 that would even partially offset the substantial increased costs Liberty would incur.
17 Thus, I cannot conclude that there would be any measurable impact on the state’s
18 economy that would be relevant to a determination of whether the transaction meets
19 either the “no net harm” or the “net benefit” standard. Further, even if there was
20 evidence of a benefit to the state’s economy as a result of the proposed transaction, I am

1 advised by counsel that this benefit alone is not a sufficient basis upon which the
2 Commission may approve the transaction as proposed by the Joint Petitioners.²

3 **Recommendation**

4 **Q. What do you recommend?**

5 A. I recommend that the Commission reject the proposed transaction as filed. The proposed
6 transaction causes a net harm to customers of Granite State and EnergyNorth and it is not
7 in the public interest.

8 While I appreciate Liberty's interest in and willingness to do business in New
9 Hampshire, it must find a way to make its operations at least as efficient as the owner it is
10 replacing. That is difficult for such a small company to do because there appear to be
11 real economies of scale in providing such support functions as customer service, billing,
12 and call center operations (and perhaps others as well, such as accounting, engineering,
13 property management, and benefits management, to name a few). The data indicates that
14 National Grid has captured at least some of those scale economies, and that benefit would
15 be lost if Liberty became the owner and operator of Granite State and EnergyNorth.

² I am advised that in *Verizon New England Inc.*, 93 N.H. P.U.C. at 68, the Commission stated: "the Public Utilities Commission is not an economic development agency but a regulatory agency exercising authority specifically delegated to it by the Legislature for the general supervision of public utilities. Consequently, even if there were evidence in the record on which one could reasonably base such a decision (which there is not), we do not have the authority to judge this transaction solely on the basis of whether maintenance of the status quo versus approval of the transaction would be a better vehicle for attracting businesses to New Hampshire. Our authority in this proceeding as it relates to jobs and economic development is limited to observing, as factors in the overall calculus of determining whether the transaction should be approved, whether the transaction provides other benefits which serve the public interest."

1 ***Possible Conditions***

2 **Q. Have you developed potential conditions that the Commission could require if it**
3 **approves the proposed transaction?**

4 A. Yes, I have, though my testimony is that the transaction as proposed results in net harm.
5 Therefore, my primary recommendation is that the Commission should reject the
6 proposed transaction. Based on the information I have available, it is neither cost-
7 effective nor in the public interest to replace the current owner (a large, capable utility
8 holding company) with the proposed new owner (a smaller holding company with no
9 experience operating a natural gas distribution utility, no financing for the transaction,
10 and a cost structure that results in higher operating costs for the New Hampshire utilities).

11 Nonetheless, if the Commission is interested in an alternative to the outright
12 rejection of the proposed transaction, I have developed an approach that could
13 substantially alleviate the net harm from the proposed transaction. I cannot say for
14 certain that it would eliminate all of the harm, and I feel confident that it would not create
15 a net benefit for customers. This alternative is designed only to hold the utilities’
16 customers harmless.

17 ***Extended Stay-Out***

18 **Q. Please describe the first component of your alternative to the transaction as**
19 **proposed by the Joint Petitioners.**

20 A. The centerpiece of my alternative proposal is to prohibit Liberty from seeking an increase
21 in rates for five years after the acquisition occurs. That five-year period should be

1 sufficient for Liberty to get through the transition process, stabilize its costs, and work
2 hard to squeeze efficiencies out of the business. During that five-year period, Liberty's
3 profits must come from enhancing efficiency, not from increasing customers' rates. If
4 the transition takes longer, or costs more than expected, Liberty must remain at risk for
5 those costs. If Liberty's new computer systems and operational methods cost more than
6 it expects, then Liberty bears the risk of those higher costs for at least several years. That
7 should provide the new owner with a significant incentive to deal with any such problems
8 cost-effectively and to drive a hard bargain with its employees, suppliers, and contractors.

9 At the very least, this five-year stay-out period means that when Liberty does file
10 rate cases, its transition-related capital expenditures will have depreciated for at least a
11 few years. Recall that the IT-related capital expenditures are estimated to exceed
12 \$6 million and depreciate over eight years. If nothing else, this depreciation will help to
13 ease the upward pressure on rates that otherwise would exist.

14 ***Reliability Standards***

15 **Q. You mentioned that one of the benefits of an extended stay-out is that it would give**
16 **Liberty the incentive to improve efficiency. Is there a potential down-side to that?**

17 A. Yes, there is. Unfortunately, I have seen some utilities respond to extended periods of
18 rate freezes or rate caps by taking actions that jeopardize the long-term safety, reliability,
19 and efficiency of service; for example, a utility may respond to a rate stay out by
20 reducing spending on preventive maintenance or eliminating training programs for new
21 employees. It is essential, therefore, for an extended stay-out to be coupled with

1 reliability safeguards. I would recommend the following requirements in addition to
2 existing customer service metrics:

- 3 • For Granite State, the System Average Interruption Frequency Index
4 (SAIFI) and the System Average Interruption Duration Index (SAIDI)
5 should be required to remain at least within the mid-range level of
6 performance over the past six years for each operating region and for
7 Granite State as a whole, measured annually.
- 8 • For EnergyNorth, the following criteria, as reported (or calculated)
9 annually to the U.S. Department of Transportation, should be required to
10 remain at least within the mid-range level of performance over the past six
11 years for each operating region and for EnergyNorth as a whole, measured
12 annually: progress in eliminating cast iron and unprotected bare steel
13 mains and services; number of corrosion leaks on mains and services;
14 known leaks; and unaccounted for gas.
- 15 • Both utilities should be prohibited from reducing the size of their field
16 workforce during the five-year stay-out, unless they affirmatively
17 demonstrate to the Commission that such a reduction can be achieved
18 without affecting the safety, reliability, and efficiency of service.

19 **Q. What do you recommend should happen if one or more of these metrics is not met?**

20 A. I recommend that the failure to meet each metric would result in an automatic monetary
21 assessment against the utility (either a penalty or an automatic rate credit for customers),
22 so that there is a direct monetary incentive for Liberty to provide a comparable level of
23 reliability to that which National Grid has been providing. Further, if the metric is
24 missed by a substantial amount, or if it is missed for two or more consecutive years, the
25 Commission should initiate a public investigation to assess the reasons for the decline in
26 performance and to determine whether remedial measures are warranted.

1 If the utility is found to have violated the workforce size requirement, the utility
2 should be required to fill the vacant position with a qualified individual and pay a penalty
3 equal to twice the average annual salary of the position.

4 **Q. What are the SAIDI and SAIFI metrics for Granite State and how did you develop**
5 **them?**

6 A. The response to OCA 2-4 provides the historic performance levels for 2005 through 2010
7 for Granite State as a whole and for each of its three operating regions, Salem, Lebanon,
8 and Walpole. I have reproduced the data on Attachment SJR-8. I also show the third-
9 best year of the past six years for each region and for the utility as a whole. In my
10 opinion, this represents a reasonable mid-range level of performance, such that the
11 Commission and the public would have assurance that Liberty is providing a level of
12 service that is comparable to the service provided prior to the acquisition. This would not
13 require Liberty to equal the best performance achieved by National Grid (though that
14 would be preferable, of course); the mid-range level recommended only requires the
15 typical level of reliability that has been achieved during the past six years.

16 **Q. What are the gas metrics for EnergyNorth and how did you develop them?**

17 A. Attachment SJR-9 shows the gas metrics I recommend. The data are taken from the
18 annual distribution reports filed by EnergyNorth with the U.S. Department of
19 Transportation, Pipeline and Hazardous Materials Safety Administration (PHMSA).
20 PHMSA publishes a database that contains the data for each natural gas distribution
21 utility in the United States. I downloaded the databases for each year from 2005 through

1 2010 and extracted the data for EnergyNorth. As shown on Attachment SJR-9, I used the
2 mid-range level of performance (third best year of the last six years) for each of the
3 following metrics:

- 4 • Corrosion leaks in mains (no more than 19 per year);
- 5 • Corrosion leaks in services (no more than 74 per year);
- 6 • Known unrepaired leaks at year-end (no more than 1);
- 7 • Unaccounted for gas (no more than 1.2%);
- 8 • Reduction in miles of cast iron and unprotected bare steel mains (at least
9 3.3%); and
- 10 • Reduction in number of unprotected bare steel services (at least 3.8%).
11

12 **Q. Why did you choose these metrics?**

13 A. As I mentioned earlier, when there is an extended stay-out, a utility may choose to defer
14 necessary maintenance or capital work rather than improve efficiency without
15 diminishing the quality or safety of service. I selected these metrics to indicate the
16 typical, on-going level of maintenance, repair, and replacement activity in which
17 EnergyNorth has engaged in recent years. In my opinion, these metrics represent a
18 reasonable mid-range level of performance, such that the Commission and the public
19 would have assurance that Liberty is providing a level of service that is comparable to the
20 service provided prior to the acquisition.

1 **Conclusion**

2 **Q. If the Commission conditioned its approval of the proposed transaction and**
3 **incorporated your recommended conditions, would there be a net harm to the**
4 **public from the proposed transaction?**

5 A. Not necessarily. My proposed conditions are designed to protect the utilities’ customers
6 by ensuring that the level of rates and basic quality of service remain unchanged under
7 new ownership. That said, it remains possible that there could be some harm to the
8 utilities’ customers even if the Commission conditioned its approval of the proposed
9 transaction and incorporated my recommended conditions.

10 **Q. If the Commission required your proposed conditions, would there be a net benefit**
11 **to the public from the proposed transaction?**

12 A. No. My proposed conditions are not designed to provide a benefit to, or to “tilt the
13 balance” in favor of, customers; my proposal is only intended to protect them from the
14 negative consequences of the transaction as filed by Joint Petitioners. If the Commission
15 holds that it is legally required to find a net benefit from the transaction, then the
16 Commission must adopt conditions that go beyond those that I recommend.

17 **Q. Does this complete your direct testimony?**

18 A. Yes, it does.