STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

April 23, 2007 - 10:14 a.m.
Concord, New Hampshire

RE: **DG 07-033**
NORTHERN UTILITIES, INC.:
Proposed Cost of Gas Filing for the Summer Period of May 2007 through October 2007.

PRESENT: Chairman Thomas B. Getz, Presiding
Commissioner Graham J. Morrison

Diane Bateman, Clerk

APPEARANCES: **Reptg. Northern Utilities, Inc.:**
Susan S. Geiger, Esq. (Orr & Reno)
Patricia M. French, Esq.

Reptg. Residential Ratepayers:
Rorie E. P. Hollenberg, Esq.
Office of Consumer Advocate

Reptg. PUC Staff:
F. Anne Ross, Esq.

Court Reporter: Steven E. Patnaude, CCR

ORIGINAL

I N D E X

E X H I B I T S

EXHIBIT NO:	D E S C R I P T I O N	PAGE NO.
1	Proposed Cost of Gas Filing for the Summer Period May 2007 through October 2007 (03-15-07)	premarked
2	Northern Utilities' responses to Staff data requests (04-13-07 & 04-20-07)	premarked
3	Revision to Proposed Cost of Gas Adjustment for the Summer Period May 2007 - October 2007 (04-20-07)	premarked
4	Rebuttal Testimony of Joseph A. Ferro (04-20-07)	81
5	Testimony of George R. McCluskey (04-16-07)	41
6	Working Capital Revenue Lag (Re: DG 06-129)	111
7	Draft Responses - Subject to review and change	112
8	Direct Testimony of Vincent Rea including attachments regarding Bay State Gas Company	116
9	RESERVED (Re: Refiling of revised JAF-1, Page 2 of 4)	129
10	RESERVED (Re: Final version of Exhibit 7 - Draft Responses)	133

P R O C E E D I N G S

CHAIRMAN GETZ: Okay. Good morning. We'll open the hearing in docket DG 07-033. On March 15, 2007, Northern Utilities filed with the Commission its cost of gas for the period May 1, 2007 through October 31, 2007. Northern proposes an average summer season cost of gas rate of 88.05 cents per therm applicable to residential customers and the rate impact on a residential heating customer's summer gas bills would be a decrease of $35, or 6.9 percent compared to 2006. For the Commercial/Industrial Low Winter Use rate classes, Northern proposes a cost of gas rate of 83.06 cents per therm. And, the rate decrease compared to 2006 is comparable to the rate decrease for residential customers. An order of notice was issued on March 30 establishing a procedural schedule, which includes the hearing for this morning.

Can we take appearances please.

MS. GEIGER: Yes. Good morning, Mr. Chairman and Commissioner Morrison. I'm Susan Geiger, from the law firm of Orr & Reno. And, with me today is Patricia French, from NiSource Corporate Services. And, also with us today are witnesses Joseph Ferro and Ronald Gibbons. Good morning.

CHAIRMAN GETZ: Good morning.

CMSR. MORRISON: Good morning.

MS. HOLLENBERG: Good morning. Rorie Hollenberg and Kenneth Traum here for the Office of Consumer Advocate.

CHAIRMAN GETZ: Good morning.

CMSR. MORRISON: Good morning.

MS. ROSS: Good morning, Commissioners. Anne Ross, with the Staff of the Public Utilities Commission. And, to my left is Bob Wyatt, an analyst in the Gas Division, and to his left is Stephen Frink, the Assistant Director of the Gas/Water Division, and to his left is George McCluskey, an analyst in the Gas and Electric Divisions.

CHAIRMAN GETZ: Okay. Good morning. Issues we need to address, before we hear from the Company's witnesses?

MS. GEIGER: No, just, Mr. Chairman, to let the Commission know that the affidavit of publication was given to the Clerk this morning. So, it's on file.

CHAIRMAN GETZ: Okay. Thank you. Then, if there's nothing else, Ms. Geiger, if you could proceed with your witnesses.

MS. GEIGER: Thank you, Mr. Chairman.

Northern would like to call Ronald Gibbons.

(Whereupon Ronald D. Gibbons was duly sworn and cautioned by the Court Reporter.)

RONALD D. GIBBONS, SWORN

DIRECT EXAMINATION

BY MS. GEIGER:

Q. Could you please state your name and business address for the record.

A. Yes. It's Ronald Gibbons. My business address is 200 Civic Center Drive, Columbus, Ohio 43215.

Q. And, Mr. Gibbons, for whom do you work and in what capacity?

A. I'm Manager of Regulatory Accounting for NiSource Corporate Services.

Q. And, are you the same Ronald Gibbons who filed direct testimony in support of Northern Utilities' New Hampshire Division Summer of 2007 cost of gas?

A. Yes, I am.

Q. Okay. I'm going to show you a document that I have asked the clerk to premark as an exhibit "Northern 1" for identification. Could you please describe the document or identify what it is?

A. Yes. This is the original filing for the Summer 2007

cost of gas. And, it contains my testimony, beginning on Page 5 through 16. And, I also prepared or had prepared schedules starting on Page 59.
Q. Thank you. Also, Mr. Gibbons, did you respond to a number of data requests issued by Staff relative to this filing?
A. Yes, I did.
Q. And, I'd like to show you a document that I've asked the Clerk to mark for identification as "Northern Exhibit 2", and ask you to identify that document for the record.
A. Yes. This is the data requests filed on April 13th, 2007.
Q. And, did you also file data requests subsequent to that time, in response to questions from Staff?
A. Yes, we filed two additional data requests.
Q. Excuse me, answers to data requests?
A. Yes.
Q. And, what was the date of that filing?
A. April 20th, 2007.

MS. GEIGER: And, just so that the record is clear, Mr. Chairman, and for other participants, Staff and the OCA, under Exhibit 2 that we've asked to be marked for identification, are the two filings that Mr.

Gibbons has just referenced. They were answers to Staff data requests, the first set was dated April 13th and the second set was dated April 20th.

BY MS. GEIGER:

Q. Now, with respect to your prefiled testimony, Mr. Gibbons, do you have any changes or corrections to either the narrative or any of the schedules that you've submitted?

A. No, I don't.

Q. Okay. Now, have you had a chance to review the rates that flew out -- that came out of Northern's March 15th filing?

A. Yes, I have.

Q. Okay. Did you make a subsequent filing?

A. Yes, we did.

Q. Okay. And, when was the date of that filing?

A. I believe it was April 20th, --

Q. Okay.

A. -- 2007.

Q. Okay. And, I'd like to show you a document that I've asked the clerk to premark for identification as "Northern's Exhibit 3". And, ask you to identify this document please.

A. Yes. This is the revised cost of gas filing updated for NYMEX price changes since the original filing was made March 15th.

MS. GEIGER: Okay. And, does everyone have copies of the April 20th filing?

MS. HOLLENBERG: Yes, we do.

MS. GEIGER: Thank you.

BY MS. GEIGER:

Q. Now, Mr. Gibbons, can you please explain for the Commission the information in your prefiled testimony, as well as the revised filing that demonstrates Northern's cost of gas for the 2007 Off-Peak Period?

A. Yes. In the revised filing filed April 20th, on Page 2 is a summary of the commodity costs and the demand costs, leading down to a total anticipated cost of gas, that is also "Thirty-first Revised Page 38" of the tariff. Those costs then are -- flow into Thirty-first Revised Page 39, which ultimately results in the calculated commodity demand and indirect rates along with the estimated amount of the working capital and bad debt allowance.

Q. And could you please summarize for the Commission the -- excuse me, the actual rates that you have calculated?

A. Yes. The revised filing has a revised residential rate of 0.8982 cents per therm, the C&I Low Winter rate is 0.8498 per therm, and the C&I High Winter is O.9465 per therm.

Q. Now, Mr. Gibbons, with respect to the information that I've shown you, of the documents that I've shown you and you've identified for the record, you've indicated that you had no changes to those. If I were to ask you the questions and present the information to you today on the stand, would that information remain the same?

A. Yes. Yes, it would.

Q. In other words, you accept that information today as your testimony?

A. Yes.

MS. GEIGER: Thank you, Mr. Chairman. I have no further questions.

CHAIRMAN GETZ: Ms. Hollenberg.

MS. HOLLENBERG: We have had a discussion with staff prior to this hearing beginning, and they were going to go before us. And, I apologize for not bringing that up with the Company at this point in time. If they object to that order, we're happy to do what needs to be done.

CHAIRMAN GETZ: Any objection to --

MS. GEIGER: No.

CHAIRMAN GETZ: Ms. Ross.

MS. ROSS: Thank you.

CROSS-EXAMINATION

BY MS. ROSS:

Q. Good morning, Mr. Gibbons.

A. Good morning.

Q. Mr. Gibbons, I'm going to start first with some questions dealing with the MPR error. And, just for the benefit of the Commission, could you describe what the "MPR error" is?

A. Yes. That is the allocation that is calculated for the winter cost of gas, and it runs for a 12-month period, and it allocates the demand costs between our Maine division and the New Hampshire Division.

Q. Now, Mr. Gibbons, on Page 5, Lines 4 through 11 of your testimony, you describe a "small error" in how the Modified Proportional Responsibility was calculated in last winter's COG calculation, is that correct?

A. Yes.

Q. Okay. And, is this MPR mechanism used by Northern to allocate supply resource demand costs, fixed costs, that is, between Northern's Maine and New Hampshire Divisions?

A. Yes, it is.

Q. Okay. To help put this in perspective, what is Northern's combined Maine and New Hampshire Division's total demand costs related to pipeline storage and supply resources?
A. Approximately $26 million.
Q. And, then, if we reference Page 86, Line 17, there should be total demand costs -- it's Exhibit 1, excuse me, there should be a total demand costs prior to allocating between the Maine and New Hampshire Divisions?
A. Yes, there is.
Q. And, could you just point that out, what line and what the amount is?
A. It would be Line 17, "$26,514,064".
Q. Okay. Thank you. Is this the same MPR that was modified and approved by the Maine and New Hampshire Commissions a year or so ago, after a great deal of analysis by the various parties?
A. The process is the same, yes. It's not the exact MPR that was approved.
Q. Could you elaborate. Sorry.
A. What was approved was the mechanism and the method of calculating the allocation between the two jurisdictions. Each year, new demand costs go in to

the MPR model and new allocations come out.
Q. Okay. And, you note the error was corrected and in effect for recording actual 2006 demand costs. When was the adjustment made to correct the OG rate for last winter? I'm sorry, COG rate, cost of gas rate, for last winter?
A. There was no adjustment necessary for the gas -- for the cost of gas rate. The effect was such that it, when you worked in the correction, it on its own did not require a correction. However, the cost of gas rates were corrected on a number of occasions during the winter, and the correct allocation of these demand costs were included when the numbers were run.
Q. So, when would the first correction have been made, to the best of your recollection?
A. Subject to check, maybe December 1st, at the latest January 1st.
Q. Okay. And, the gap between November and whenever the first correction was made, whatever over or under allocation was done, you could correct effectively for the rest of the period, is that what you're suggesting?
A. Yes.
Q. In the revised filing for this summer COG, you note the reconciliation of last summer 2006 gas costs have been

revised to correct the allocation of prior period adjustments between the Maine and New Hampshire Divisions. Is this correction related to the November 2006 correction you note in your testimony?
A. It is not.
Q. Okay. And, could you just describe what the new problem was with the allocation then?
A. Yes. When I was preparing documents for the joint audit conducted by the New Hampshire Division staff and the Maine Division staff, I noted that the Accounting Department had, on their spreadsheets, when they had entered the gas costs, that the correct prior period adjustment amount was not flowing on the spreadsheets. So, I corrected for that prior to the audit, and the corrected sheets are what were audited by the two staffs.
Q. I guess I'm not understanding the timing. Were those corrected amounts what were actually collected in rates or was that an after-the-fact correction again?
A. It was after the fact.
Q. But it's your testimony that the correction at the end of the period came out all right, that it was consistent with the way it should have been allocated throughout the period --

A. Yes.

Q. -- for demand costs?

A. Yes. And, it wasn't all just demand costs. It was commodity costs also.

Q. In the future, if the Company discovers an error in a previously approved cost of gas calculation, would it be willing to notify Commission Staff of the error and subsequent correction via the first monthly cost of gas report reflecting the correction?

A. Yes, we would.

Q. Okay. I'd like to deal a little bit with the prior period over collection. And, I'm going to reference Page 7, Lines 3 through 7 of your testimony. The prior period over collection of $633,021 was, as shown on Tariff page 39, is not the same as the prior period over collection of $611,704 as shown in the "reconciliation" section of the filing. Is the difference between the two numbers simply additional interest incurred and added onto the end-of-period balance from the prior summer cost of gas period?

A. Yes, it is.

Q. Is this the interest calculation provided on Page 113 of the filing?

A. Yes, it is.

Q. Did the Commission Audit Staff review the costs from the prior period as reflected in the reconciliation of this filing?
A. Yes, they did.
Q. And, we would note that that Final Audit Report on last summer's gas costs is not yet complete, but Staff does expect -- not expect any substantive changes.
A. That's what's my understanding.

MS. ROSS: Okay. I have no further questions for this witness.

CHAIRMAN GETZ: Ms. Hollenberg?

MS. HOLLENBERG: No questions. Thank you.

CHAIRMAN GETZ: Redirect?

MS. GEIGER: No thank you, Mr. Chairman.

CHAIRMAN GETZ: Then, the witness is excused. Thank you.

MS. GEIGER: Northern would like to call Mr. Joe Ferro.

(Whereupon Joseph A. Ferro was duly sworn and cautioned by the Court Reporter.)

JOSEPH A. FERRO, SWORN

DIRECT EXAMINATION

BY MS. GEIGER

Q. Could you please state your name and business address for the record.

A. My name is Joseph A. Ferro. My business address is 300 Friberg Parkway, Westborough, Massachusetts.

Q. And, Mr. Ferro, for whom do you work and in what capacity?

A. I work for Bay State Gas and Northern Utilities, in the capacity of Manager of Regulatory Policy.

Q. Are you the same Joseph Ferro who filed direct testimony in support of Northern Utilities' New Hampshire Division cost of gas for the summer period, specifically regarding the proposed introduction of the Simplified MBA method?

A. Yes, I am.

Q. And, Mr. Ferro, I'd like to show you what's been marked for identification as "Exhibit 1", and ask you to identify within that exhibit any information that relates to your prefiled testimony.

A. Yes. Within Exhibit Northern 2, my testimony, and what I'm responsible for in this filing, starts on Page 18, which is the first page of my prefiled testimony. It's a separate section labeled "Prefiled Testimony of Joseph A. Ferro". And, it goes through Page 57D of the

filing. So, Page 18 to 57D includes my prefiled testimony and all the schedules attached to that testimony.
Q. And, Mr. Ferro, I believe you just indicated or referred to "Exhibit Northern 2". Did you mean to say "Northern 1", "Exhibit 1"?
A. I'm sorry. Yes, I stand to be corrected, Exhibit Northern 1.
Q. And. Did you also assist with the preparation of responses to Staff's two set of data requests that have been marked for identification as "Northern's Exhibit 2'?
A. Yes.
Q. Okay. Now, were the exhibit that you just referred to within Exhibit 1, the information relating to your prefiled testimony and schedules, prepared by you or under your direct supervision and control?
A. Yes, they were.
Q. And, do you have any changes or corrections that you'd like to make to that information at this time?
A. I do not.
Q. Okay. Now, Mr. Ferro, could you please explain for the Commission the reasons why Northern has introduced the SMBA into this cost of gas and why the Commission

should recommend -- why the Commission should, in fact, adopt the proposed change?

A. Certainly. To begin with, let me just give a little bit of history on the cost of gas methodology. It attempts to allocate costs to rate classes or customer groupings, based on the cost that is incurred to serve such a load. The "MBA" stands for "market-based allocation". And, the Market-Based Allocation Gas Cost Methodology was introduced in the mid 1990's. First, for Bay State Gas Company, in the 1995 rate redesign proceeding; later, for a couple of other utilities in Massachusetts; also for Northern Utilities' Maine Division in the late '90s; and, in fact, in 2000, for the Northern Utilities' New Hampshire Division. The Market-Based Allocation was first created was a very detailed methodology of assigning costs to each rate class based on each resource that was dispatched in the model.

Now, when -- the reason for the Market-Based Allocation to be introduced, (a) one would say is you really want to have more cost-based gas cost rates, instead of an average cost of gas for all rate classes. But the second reason why it was introduced was it came into -- it came to light that utilities were unbundling. And, gas-on-gas competition was surfacing. Suppliers could come in behind a utility's -- utility's distribution system and offer gas supply service to its customers. And, in fact, suppliers would charge for gas supplies in a manner based on how the customer's load profile presented itself. That is, if you had a customer or customers whose load was completely flat, the supplier could go out and buy a long haul gas supply, i.e. purchase gas from the Gulf, contract for firm capacity of the upstream pipeline, and serve that customer those resources. That would generate the lowest average cost of gas I guess one could imagine, because it was just pipeline resources and would not include supplemental gases or underground storage costs. And, so, that's where it came about. And, as we were unbundling in all our jurisdictions, and as utilities were unbundling in Massachusetts, it made even better sense to introduce those gas cost rates.

Now, that was the onset of introducing such a detailed calculation. But, over time, it was -- it came to us that you could simplify the methodology such that it was more reviewable for regulators, it was more easily put together for the Company, and not losing any kind of accuracy, if you will, of coming up with load factor based rates. And, in fact, when we introduced the MBA methodology in the Northern Utilities' Maine Division in a '97 docket, in a rate redesign case, we just simplified it very, very slightly, in that the MBA applied a monthly dispatch, instead of a daily dispatch that was introduced in the mid 1990s.

Now, for the New Hampshire Division, what we did was we ran a full MBA in the rate redesign case, I believe it was docket DG 00-046. And, coming out of that rate redesign case, we established percentages or ratios to apply to the average cost of gas to come up with a commercial/industrial rate for the Low Winter, which is a really high load factor class, and the High Winter or low load factor C&I class. And, through a settlement, we kept the residential rate as the average cost of gas. And, so, we did -- we did run a complicated, highly detailed MBA, but we attempted to simplify it. "We" being the Company, and Staff and the OCA, by using this test year level, the test year, by the way, in that docket was 12 months ending September 1999, I believe. And, so, we established those percentages and moving forward.

Now, it was the agreement of the Staff and the Company and the OCA that we would monitor this and try to make sure rates didn't get sort of out of alignment, if costs changed or the Company's requirements, load profiles changed. Well, in fact, they did start changing. And, we had some strange cost of gas rates for C&I High Winter and C&I Low Winter. In fact, it was very, very different. The C&I Low Winter rate was much, much lower than the average cost of gas. And, the C&I High Winter rate was much higher than the average cost of gas. To the extent that the Low Winter class rate was below market and the High Winter rate was very, very high, where suppliers could look at that rate and say "Oh, I could really save that customer money. I can sell gas at a lot lower rate than that."

So, that was going on for a couple of years. And, you may recall that, in a cost of gas docket, it was a summer docket, I believe the Summer 2005, the Company introduced a modification to coming up with these ratios. And, we used the demand cost allocation where we designed, we come up with capacity allocators or capacity assignment. We used those, that data, if you will, to come up with ratios to apply just to the unit demand costs. And, that helped a lot, but certainly didn't show a full market-based rate for a High Winter class or a Low Winter class. And, again, we still used our what we call a "straight 2-season" gas cost methodology in New Hampshire, unlike in Maine, which is the MBA, unlike in Bay State Gas, in Massachusetts, which is the MBA.

So, recently, the Company, and I say "the Company" loosely here, Bay State Gas and Northern Utilities, looked to simplify the MBA. And, in Massachusetts, Bay State Gas, in its last rate case, in a 2005 rate case, introduced a Simplified Market-Based Allocation CGA. And, the Simplified Market-Based Allocation CGA comes up with just two rates, High Load Factor and Low Load Factor, instead of each rate class's rate, which is six C&I classes and two residential classes. And, in fact, we introduced a simplified MBA also in Maine, for the Northern Utilities' Maine Division. And, coincidentally, in this -- coincident with the Maine proposal, we're introducing the simplified MBA in this docket.

Now, it's simple when you compare MBA and MBA, in that, as I mentioned earlier, the MBA is a daily dispatch of every resource, 365-day dispatch in the model. The SMBA is a monthly dispatch. The SMBA just categorizes three resources; pipeline, which is base load and then remaining, and then underground storage and peaking. So, it's pipeline, underground storage, and peaking. While the MBA, we have each resource separated, ranked separately, dispatched separately, over twenty resources instead of three, and we rank them based on fully loaded costs, i.e. commodity and demand.

Another simplification of the SMBA uses a single, normal year dispatch for both commodity and capacity. The MBA used a normal dispatch for commodity and a design dispatch for capacity. As I mentioned, the SMBA allocates costs by load factor, High Load Factor C&I, Low Load Factor C&I. And, by way of agreement, we kept the average cost of gas for the residential. The MBA separated each rate class. You had three classes within the High Load Factor C&I class, you had three load factors within the Low Winter C&I class. Well, in fact, the rates within the load factor groupings were very, very similar. So, we didn't gain that much precision. So, we simplified to keep it to two load factors. And, then, one other real important point to the SMBA versus the MBA. The SMBA assigned costs to the -- assigned demand costs based on a design day demand. That means each load groupings are peak or max day demand, was the basis for allocating demand costs. Well, that's precisely how we assign capacity to a customer who opts to take transportation service, i.e. goes from our cost of gas bundled sales service to the transportation service. So, that customer, who's paying for demand costs through the cost of gas, under the SMBA, is paying the same allocated share of demand costs as he or she will when going to transportation service and getting assigned the Company's capacity. Well, the MBA didn't do that. The MBA allocated capacity costs using a Proportional Responsibility weighted design year monthly allocation. So, there was a little bit of inconsistency, a little bit out of synch. So, there was not a complete level playing field of the customer paying for the Company's capacity resources under bundled sales service versus under transportation service.

So, with that backdrop, the SMBA was simpler than the MBA and achieved a more consistent way of assigning demand costs. Both are market-based, both really represent how suppliers would charge for supply.

Now, certainly, my simplified reasoning for changing in New Hampshire doesn't ring real clearly, because, as I said, we are on a straight 2-season cost of gas in New Hampshire. But, nonetheless, it creates consistency throughout the Northern Divisions, Massachusetts, and Bay State, as well as other Massachusetts Divisions. But, more importantly, for New Hampshire, it creates more market-based rates for the C&I classes. It fully allocates commodity and demand based on load factor or load profiles, and, therefore, sends out the right price signal for C&I classes, as compared to today's rates.

So, those are the reasons why the SMBA makes a lot of sense in New Hampshire, as well as other divisions, and why I feel that this is a great time to be implementing it.

Q. And, Mr. Ferro, have you discussed the SMBA methodology with Commission Staff and the OCA?

A. Yes, I sure have.

Q. And, do you -- could you please state for the Commission what your understanding is with respect to their positions, whether they agree with or disagree with the SMBA?

A. My understanding is that Staff understood and seemed to be in agreement making this move. They certainly didn't have any strong objections to changing to the Simplified MBA, as far as my understanding.
Q. Okay. And, Mr. Ferro, shifting gears a bit to information provided to the Commission this morning by Mr. Gibbons, you were present when Mr. Gibbons testified this morning, correct?
A. Yes, I was.
Q. Do you have any information that you would like to add to round out the record with respect to information presented by Mr. Gibbons?
A. Well, I just wanted to -- Mr. Gibbons said, as far as I heard, everything that was true and accurate. But I just wanted to make sure it was clear to the Bench and clear to Staff, and, in fact, what it seemed to -- what Attorney Ross was trying to glean from this, and that is the MPR or the Modified Proportional Responsibility is, in fact, the method that was approved by the Maine and New Hampshire Commissions, and, in New Hampshire, in docket DG 05-080. And, that was a methodology that fairly assigned demand costs based on firm sales requirements and requirements associated with transportation customers who are assigned capacity.

And, that approved, Modified Proportional Responsibility methodology is, in fact, the exact methodology that was used to correct the demand cost allocation that we inadvertently filed and implemented on November 1. And, so, sometime after that filing, we discovered that the percentages were flip-flopped, and it was hard to discover in a sense that those percentages were close to 50 percent, 50.5 versus 49.5 or something like that. And, so, we discovered it and we did, obviously, did what was intended to be done, and that is use the correct Modified PR allocation of demand costs going forward, and took the opportunity in this filing to file the corrected schedules and to show that demand cost allocation in this filing.

I do want to add that the Company feels, and me, personally, feel it's quite a reasonable request by Staff that, in the event something like this happens again, the Company, which chose to notify both the Maine and New Hampshire Staffs through a formal filing in the summer cost of gas, could just as easily notify them in somewhat of a less formal way earlier on, once it found out. That's all I want to add to that.

Q. Thank you, Mr. Ferro. And, I neglected to ask this question at the time that I asked you to identify your prefiled testimony and schedules. But, if I were to ask the same questions today of you on the stand that were asked in your prefiled testimony, would your answers be the same?

A. Yes, they would.

MS. GEIGER: And, with that in mind, Mr. Chairman, this witness is available for cross-examination. Thank you.

CHAIRMAN GETZ: Is the intent, Ms. Geiger, to bring him back to handle the rebuttal testimony separately?

MS. GEIGER: Yes. Thank you, Mr. Chairman. I meant to mention that as well. I spoke with Attorney Ross, and she indicated that it would be appropriate for Mr. Ferro to testify at this point in the proceeding on his direct prefiled testimony with respect to the SMBA, and then Mr. McCluskey would testify with respect to his proposal for a changed methodology in the COG, and then Mr. Ferro would come back on the stand to present the rebuttal testimony that he filed with the Commission on Friday.

CHAIRMAN GETZ: Thank you. Ms. Ross.

CROSS-EXAMINATION

BY MS. ROSS
Q. Good morning, Mr. Ferro.
A. Good morning.
Q. Mr. Ferro, you discussed a little bit, but I'd like you to just elaborate somewhat further, on the difference between the current straight what we call "2-season" New Hampshire methodology. And, could you just summarize in very general terms, because I understand that, from your earlier testimony, the Simplified MBA is driven primarily by the C&I customers and the competitive needs. I'd like to ask you to focus for a minute on the residential customers. And, in general terms, how does the current straight season methodology affect a residential customer's COG rate?
A. Yes. Well, as I mentioned earlier, through the Settlement Agreement in, I believe, DG 00-046, the Company, Staff, and the OCA agreed to charge just the average cost of gas for residential. And, the basis for that, and, certainly, the OCA could correct me on this, but the basis for that was that we wanted to keep residential out of the unbundling fray. They were not going to have the opportunity to take transportation service, so they wanted to be -- the idea was not to affect them on gas costing that was related to

unbundling. I will say, personally, that, and I already did say, in fact, that the MBA certainly was sort of invoked or prompted a little bit by the unbundling scenario. But it also does generate cost-based rates. So, one could argue or at least contend that the residential class, because of their load profile, should also be part of the SMBA or the MBA calculation. Again, and there's two reasons why we applied the MBA or the SMBA. It's for equal playing ground for gas-on-gas competition, but it also is a cost-based way of allocating gas costs.

So, with that backdrop, I haven't answered your question, though, for that backdrop, the residential class is being billed the average cost of gas. Well, with the SMBA versus the common straight 2-season, the SMBA does allocate more demand costs to the winter than a straight 2-season. The straight 2-season just identifies capacity or demand costs associated with winter supplies and deferred them to the winter. The SMBA takes an annual assessment of that. Runs dispatch on an annual -- on an annual forecast and assigns costs based on how supplies are being used winter and summer. And, that results in more demand costs being charged to the wintertime. So, sort of some of the pipeline demand costs go into wintertime. And, so, if I try to assess how the residential class is going to be affected, well, they're still being billed the average cost of gas. In fact, the average cost of gas might be a little bit lower in the summertime. And, even slightly lower -- slightly higher in the wintertime. But, because a shift of dollars impacts the summer rate more than the winter rate, because there's less volume for the summer, more volumes for the winter. The reduction in the average cost of gas, i.e. the residential rate, will be greater in the summer and a slight increase to the residential class, i.e. the average cost of gas in the winter. I think that answers your question.

Q. Could you elaborate on a statement you made earlier, and it was also, I think, contained in your testimony. You say that the SMBA method sends better commodity price signals to the C&I Low Winter and High Winter classes. Could you elaborate on that statement please?

A. Certainly. As I said earlier, it's better being -- better than what we currently do and better than what we did in the past when we fixed those ratios. What we do current -- What we were doing currently, or up to May 1, at least, is that we just applied ratios to the demand component, a ratio that didn't quite reflect design day demand allocation of costs, but it did nothing to the commodity. And, the SMBA runs the dispatch and assigns unit commodity costs based on the gas supply used to satisfy each C&I grouping's load. And, in fact, what we've seen over the last couple of years, and it's somewhat counterintuitive to some people, is that the unit commodity cost has gone up -- has gone up and exceeded, has gone for the -- excuse me -- for the C&I Low Winter, which is the high load factor class, the unit commodity cost has gone up as compared to the C&I High Winter or low load factor class to the extent that it's exceeded. And, that seems counterintuitive. But why that is is because long haul natural gas supplies, on a commodity basis, have been very volatile, as we all know, and has climbed dramatically. And, so, even though, on a fully loaded cost basis, long haul pipeline gas is the cheapest gas supply, and, moreover, is the supply that needs to be used to satisfy base load requirements, year-round, flat load requirements.

The unit commodity cost of that fully loaded cost is higher than a lot of the supplemental gas supplies, it's higher than the underground storage gas supplies. So, the SMBA captures this. And, if one looks supposedly at the cost of gas calculation, the unit commodity costs might be a little bit higher for that Low Winter or high load factor class, as compared to the High Winter or Low Load Factor C&I class. Well, certainly, the demand costs, though, are much lower, the unit demand cost, for that Low Winter or High Load factor class. Because your Low Factor is better, they utilize supplies in more days of the year, and that the capacity costs for some of the other supplies are lower than other suppliers.

So, the SMBA just takes a look at the whole picture of demand and commodity and comes up with unit demand costs, unit commodity costs, and overall unit costs, to assign to the High Load Factor C&I classes and the Low Load Factor C&I classes.

Q. On Page 11 of your testimony, beginning about Line 21, you described how SMBA creates 3 categories of supply resources. Can you explain the significance of these supply resource categories? Do they relate to specific portions of Northern's load curve?

A. Certainly. But could you tell me what page again?

Q. Page 11.

A. Thank you.

MS. GEIGER: And, just so that the record is clear, I believe this is Page 28 of the consecutively numbered pages contained in Exhibit 1.

MS. ROSS: Thank you.

THE WITNESS: Thank you. And, I am there, and it spills over to Page 29.

BY THE WITNESS;

A. Yes. As I said in my direct examination, the SMBA categorized three resources, opposed to the MBA that had 20 plus resources. And, those three resources are pipeline, underground storage, and peaking. Now, with the pipeline, you have pipeline resources that are related to the long haul Tennessee gas, related to any pipeline gas that would be coming by way of Iroquois or down the Canadian line. And, of that pipeline gas, we utilized a certain amount to fill the base load level of requirement year-round for all customers. And, then, we have remaining pipe --

BY MS. ROSS

Q. Well, if you don't mind an interruption, can I infer from what you're saying that a Low Load Factor customer, that is a customer who's load doesn't vary wildly during the course of the year?

A. That would be a High Load Factor customer.

[Witness: Ferro]

Q. I'm sorry. I misstated it. A High Load Factor customer would be allocated mainly from the pipeline resource, whereas a Low Load Factor customer, who's load does fluctuate during the year, would have a higher allocation from the pipeline and underground storage resources.

A. Right. Right, you're own the right track. Correct. Just a minor correction. They would have a higher percentage of their load be satisfied by underground storage and peaking, and a lower percentage of the pipeline for that Low Load Factor class, than the High Load Factor class.

Q. Thank you.

A. That's correct. So, anyways, to continue on with the explanation. So, you get one resource is pipeline, and the pipeline satisfies base load, and then the remaining gets allocated above base load, based on each rate class or rate groupings demand. And, then, the second resource is undergroud storage. Undergroud storage is basically a 151-day service in the wintertime. We withdraw gas from November, at least through March, and that would be the next supply satisfying all the demand above the pipeline. And, those are withdrawals of undergroud storage.

[Witness: Ferro]

And, then, the third resource is peaking. And, the peaking resource, as I believe most of us are familiar with now, is generally the Duke Energy resource, the Distrigas resource, the Company's produced LNG from its on-system storage facility and its liquid propane or propane/air peaking supply, again, from its on-system plants. Those are the peaking resources.

Q. Under the SMBA method, will additional costs be shifted between Northern's Maine and New Hampshire Divisions?

A. I'm glad you asked that question, because I wanted to say up front, as I have in prefiled testimony, that whatever's cost of gas methodology we use, whether it's MBA, SMBA, two straights -- straight 2-season, that does not impact the allocation of costs between the New Hampshire and Maine Divisions. Because the cost of gas methodology is applied after the costs are allocated to the two divisions, costs are allocated between the two divisions based on two manners. Demand costs are allocated by the Modified Proportional responsibility, as we discussed earlier. And, commodity costs are allocated to the two divisions, based on monthly firm sendout volume ratios. And, they are allocated that way on a modeling basis, and they are certainly allocated that way on an actual basis, when the actuals come in. So, SMBA, MBA, straight 2-season, whatever methodology one uses, has zero impact on the costs being allocated between the two divisions.

MS. ROSS: Thank you, Mr. Ferro. I have no further questions at this time.

CHAIRMAN GETZ: Ms. Hollenberg.

MS. HOLLENBERG: Thank you. No questions.

CHAIRMAN GETZ: Redirect?

MS. GEIGER: No thank you.

CHAIRMAN GETZ: Then, you're going to have an interim break here. We'll see you shortly. Thank you.

THE WITNESS: Thank you.

MS. ROSS: I would like to request about ten minutes. We weren't anticipating not having access to Mr. Ferro for his rebuttal testimony. So, I just need to speak with my witness before we begin his direct.

CHAIRMAN GETZ: I'm sorry, I don't understand what you mean by that, "not having access" to him?

MS. ROSS: Well, we'll get to question him later on his rebuttal testimony. I had assumed we would be crossing him now on rebuttal. I misunderstood Northern's position on that, and I just need a few minutes to prepare with George on direct.

CHAIRMAN GETZ: Any objection to taking a brief recess?

MS. GEIGER: No.

MS. ROSS: Sorry.

CHAIRMAN GETZ: Okay. Then, we'll take a brief recess.

(Recess taken at 11:05 a.m. and the hearing reconvened at 11:21 a.m.)

MS. ROSS: I would like to call George McCluskey to the stand.

(Whereupon George R. McCluskey was duly sworn and cautioned by the Court Reporter.)

GEORGE R. McCLUSKEY, SWORN

DIRECT EXAMINATION

BY MS. ROSS

Q. Good morning, Mr. McCluskey. Would you please state your name and your position for the record.

A. My name is George McCluskey, and I'm a Utility Analyst working in the Gas and Electricity Divisions of the New Hampshire Public Utilities Commission.

Q. And, Mr. McCluskey, briefly, what is your experience in the gas area?
A. I guess this is my second time around on gas issues. When I first joined the Commission, how many years ago, it must have been 17, 18, and that's just a guess, I was assigned as a Gas Analyst, and worked on mainly ratemaking issues in gas for three or four years, before moving onto electric issues. Since returning to the Commission almost two years ago, I've spent my time on gas and electric ratemaking issues primarily.
Q. Mr. McCluskey, did you prefile testimony in this docket on April 16?
A. I did.
Q. I'm going to show you a copy of what I believe you prefiled, if you could just confirm that this is your testimony?
A. That's correct.

MS. ROSS: I'd like to mark this testimony for identification purposes. I believe you all have copies.

CHAIRMAN GETZ: Yes.

MS. ROSS: And, I don't know what exhibit number that would be assigned.

MS. BATEMAN: Five.

CHAIRMAN GETZ: It's marked for identification as "Exhibit Number 5".

(The document, as described, was herewith marked as Exhibit 5 for identification.)

BY MS. ROSS

Q. Mr. McCluskey, would you please briefly describe why you chose to file testimony in this docket?

A. Yes. Well, essentially, my testimony addresses two issues. One relates to what's called the Company's "cost of gas reconciliation calculation" or "mechanism". And, the other one -- and, that mechanism, by the way, results in an adjustment to the utility's cost of gas, either up or down, depending on whether the reconciliation produces a over- or undercollection. So, that mechanism results in a rate adjustment to what otherwise would be the cost of gas rate for the upcoming period. The second area that I address relates to a second rate adjustment that the Company applies to its cost of gas rate, and that is to recover its cost of financing the supply-related cash working capital. And, the issue I address there is the appropriate carrying charge that the Company -- that should be used for calculating the interest on the cash working capital requirement.

And, why did I file testimony? The reason had to do with the first issue that I mentioned, the reconciliation calculation. This issue arose -- The issue essentially is the proper methodology for developing the reconciliation calculation. This issue arose in Staff's review of Unitil's over- or undercollection or reconciliation calculation for Default Service. Essentially, Default Service, Default Power Service and gas supply costs are very similar, the ratemaking is very similar for both. There's a lot of components to the development of Default Service and the cost of gas rate that are common for both electric and gas companies. So, we -- Staff came across what we believed was a problem related with the reconciliation calculation for Unitil that we believed resulted in the overcollection of what is called the "cost of financing timing differences", and I'll get into that a little bit more later.

But it's kind of a long story to that proceeding. The Company initially agreed -- Unitil initially agreed with Staff's position, then changed its mind, then changed its mind again, and Unitil and Staff entered into an agreement that resulted in a change in the methodology for calculating the over-/undercollection. And, Staff subsequently applied that same agreement to National Grid's Default Service reconciliation, and also to a reconciliation for transmission expenses for Public Service Company of New Hampshire. Those two latter agreements were -- changes were with the agreement of the two utilities, National Grid and PSNH.

So, having done this for three electric companies, Staff reviewed the reconciliation calculation for both Northern Utilities and for KeySpan. And, we've determined that those methodologies suffer from the same problem that the electric utilities suffered from. And, it's as a result of that review that caused Staff to submit testimony in this proceeding recommending a change in the reconciliation methodology.

Q. Mr. McCluskey, I wonder if I could ask you to talk a little more specifically about the cost of gas reconciliation and what timing differences are built into the reconciliation as it's currently calculated by the Company?

A. Okay. Well, this is really getting to the heart of the problem. I think I'll actually start by talking about the working capital calculation, and then we'll move onto the -- move back to the reconciliation calculation. What the working capital -- What the working capital rate adjustment does is it compensates the Company for the interest on the cost to finance the net lag between the payments of gas costs and the receipt of revenues. And, that net lag is generally determined by a lead/lag study. Northern Utilities -- Northern Utilities' last lead/lag study was done I believe in a rate case in the 2001 or 2002 time period. And, that produced an average net lag of 6.33 days. So, that's the, on average, the number of days that the Company has to finance the fact that its revenues come in later than it pays its gas supply bills. And, so, essentially, the Company's either got to finance that through internal cash or some kind of external borrowing, and, hence, there is a financing cost to that. The Company eventually gets this delayed revenue, and, hence, it doesn't seek recovery of the principal. It's really just the interest on the principal for those on average 6.33 days every month. And, so, that's -- that net lag resulting from the lead/lag study is generally referred to as a "timing difference". And, if the Company's lead/lag study is conducted appropriately, then the Company will be fully compensated through this working capital rate adjustment to the cost of gas for the cost of that timing difference.

Now, when we -- we'll now turn to the other mechanism, the reconciliation calculation. And, what that does is it looks at not the going forward period, but a prior period. It essentially asks the question "was there a balance or imbalance every month between the costs of gas supply paid out and the revenues received?" And, typically, the answer is "no". There's generally some -- some imbalance, sometimes it's an overcollection in one month, it's sometimes an undercollection. And, what the Company is allowed to do is -- what the Company does is, each month, for a particular period, let's say the winter period, it will track this monthly over-/undercollection, and, in the process, that imbalance again has to be financed, and it will calculate the carrying cost or the interest on that imbalance, and do this every month of this period. And, so, at the end of this, say, the winter period, I know we're in the summer CGA at the moment, the same thing happens during the summer months, the Company will track the imbalance, and it may be, at the end of this period, there's a significant undercollection. That, when you add the interest on for each month, that will increase the undercollection, and the Company will seek to recover not only the undercollection, but also the interest on that through this second rate adjustment to the cost of gas.

So, the issue is "what is causing that imbalance on a monthly basis?" And, Staff has determined, based on the research it's done and the report that it prepared and I've submitted as an attachment to my testimony, that there are several reasons for the imbalance in any particular month. But one that we've determined is that there's a timing difference, a lag of just over 15 days, due to the fact that each month the Company is comparing gas costs, which are booked on -- which are presented on what's called an "accrued basis", with revenues which are based on a "billed basis". So, there's a mismatch in terms of the accounting for costs and revenues, and that mismatch is really -- produces a lag, which has already been addressed in the working capital calculation. And, so, it's Staff's position that the Company is under -- is overrecovering the cost of the timing difference, because it has the same 15 day lag in both the -- represented in both the lead/lag study and, hence, the working capital calculation, and in its reconciliation calculation.

The very same issue that we raised for the electric companies and the electric companies accepted that and agreed to change the method, and the change is to match accrued costs with accrued revenues every month. We will still find that, going forward, for the electric companies, and I believe we'll also find it for the gas companies, if they make the same change, there will still be differences from month to month, but the differences will be much smaller, because we will have eliminated a significant reason for that mismatch, which is already taken care of in another rate adjustment.

So that in, and maybe I've -- I'm not sure whether I responded to the question, I kind of went off.

Q. I think you did. I think you did. And, just to clarify a little further, it's true, isn't it, that this -- using these billed revenues and building in this 15 day delay, as the Company has been doing on this cost of gas reconciliation, if you look at a month like November, which happens to be the first month in a period, what you see is a large undercollection, and then, because that undercollection is netted each month, it actually carries through the whole period. Is that a correct description of the effect of lagging those revenues in that first month of a period?

A. Very roughly. The problem really is the first month of this period, whether it be in the summer period or the winter period. Because, in effect, the Company has less than the full month of revenue in that month. In the subsequent months, there's not -- there's not a perfect match with costs and revenues, but there's much less difference. And, hence, the under- or overcollection, it's essentially an undercollection in the first month, that has a tendency to flow right throughout this period. And, the Company is essentially charging interest on this imbalance right throughout the period. But it's really the first month that causes this problem.

In fact, I would like to, Commission, if you could refer to -- this is to Mr. Ferro's testimony submitted in this proceeding, Attachment JAF-1.

CHAIRMAN GETZ: You're talking about Exhibit 1?

THE WITNESS: Exhibit 1. And, if you go to -- I believe it's his first attachment, Page 1 of 4.
CHAIRMAN GETZ: Do you have the page number down at the bottom right-hand corner?
THE WITNESS: I don't believe there is a page number in that.
MS. GEIGER: Just so that the record is clear, we'd ask that Mr. Ferro's rebuttal testimony be marked as "Exhibit 4", and that hasn't been --
THE WITNESS: Sorry.
MS. GEIGER: -- hasn't been spoken about yet, since Mr. Ferro hasn't taken the stand yet with respect to his rebuttal. So, I think that might be the piece of information that Mr. McCluskey is referring to.
THE WITNESS: I apologize. I had forgotten that his testimony has not yet entered the record.
BY THE WITNESS:
A. But, if I could, if I could refer you to Attachment 1 of the report that is presented as "Exhibit 2" in my testimony.
MS. ROSS: And, that is Page 21 of Mr. McCluskey's prefiled testimony.
BY THE WITNESS:

A. Okay, Commission. If you could focus on the month of November '05. This is -- This schedule here really is a reconciliation for the winter period, which begins November. It has some earlier months, I will not get into why that is the case. But, if you could just imagine we're looking at the reconciliation for the six months beginning November of '05, running through April of '06. And, if you could see the gas costs for that month are over $5 million, which is the second line down. You got that? And, the billed revenues, using the Company's approach to developing the revenues, are 1.5 million, 1.6 million.

If you turn the page to Attachment 2, this Attachment is attempting to represent the same calculation, but using what are called "accrued revenues". And, these estimates -- these revenue estimates of accrued revenues were provided by the Company, to Staff. And, what you see in the month of November, you've got the same cost, because it's they're both on accrued basis. But now we've got the accrued revenues, which are now up to $4.8 million. So, while there's not a match for other reasons, the difference is significantly smaller, and, hence, the interest that will be charged on that difference would be substantially smaller as well.

And, this miss -- going back to Attachment 1, this mismatch, significant mismatch in the month of November, tends to feed itself through, right throughout the winter period, and the Company continually charges interest during those months. So, that's what we've tried to correct here. We're trying to have a proper matching of costs and revenues by using accrued costs and revenues, and not a mixture of accrued and billed revenues.

BY MS. ROSS

Q. Just to go back for a minute to the concept of "accrued". With regard to the gas costs in a month, Mr. McCluskey, there is actually what we call a "lead", isn't there? In other words, the Company may actually consume or obtain gas supplies in that month that it doesn't get billed for until well into the subsequent month, is that correct?

A. That's correct.

Q. So, by using accrued costs in this chart, the Company is basically accelerating costs to show them incurred at the time that it makes that commitment that it actually obtains the gas and becomes obligated to pay, correct?

A. I don't think the Company is attempting to show "incurred costs". It's essentially calculating the costs associated with consumption in that month. And, it's not saying "when were those costs actually paid?" It's essentially doing a calculation, "what are the costs associated with consumption in a month?" And, we believe that the Company should be doing the same when it comes to revenues. What are the revenues that you will recover associated with consumption in that month? And, that is the matching of accrued costs and accrued revenues, regardless of when costs are paid or revenues are received. The lead/lag study takes care of leads and lags in the payment and receipt of costs and revenues.

MS. ROSS: Thank you. I have no further questions for the witness. The witness is available for cross-examination.

CHAIRMAN GETZ: Ms. Hollenberg.

MS. HOLLENBERG: Thank you. I just have a few questions. Good morning.

THE WITNESS: Good morning.

CROSS-EXAMINATION

BY MS. HOLLENBERG

Q. The Settlement Agreement that you mentioned in your

testimony just now with Unitil, PSNH, and National Grid, you would agree that the OCA participated in those settlement agreements, wouldn't you?
A. I did. I struggled to remember those that might have participated in them. But it was a group effort, and there were settlement agreements in separate proceedings. PSNH's was in the rate case, Unitil was in a Default Service case, as was the -- there was no settlement agreement with National Grid. They simply agreed to apply the method that had been adopted for Unitil.
Q. Okay. Thank you. And, you're not disputing the accuracy of the 6.3 net lag days in Northern's working capital, are you?
A. Absolutely not.
Q. Okay. And, do you have Mr. Ferro's rebuttal testimony before you right now?
A. I do.
Q. Could you turn to Page 9 please.
A. Okay.
Q. On Line 15, there's a number "15.2 days" there?
A. Yes.
Q. Do you -- Would you agree that the 6.3 included on the revenue lag side includes that 15.2 days?

A. Yes. The 6.3 is a net of leads and lags. Both the leads and lags have a 15 day component to them. So, they essentially net out.

Q. And, would you agree that, by the Company basing their over/under recovery balance on billed revenues, that they are again seeking to recover the same 15 days?

A. Yes. The billed revenues are essentially shifted relative to costs by approximately 15 days.

MS. HOLLENBERG: Okay. Nothing further. Thank you.

CHAIRMAN GETZ: Ms. Geiger.

MS. GEIGER: Thank you. Good morning, Mr. McCluskey.

THE WITNESS: Good morning.

BY MS. GEIGER

Q. Now, Mr. McCluskey, you're neither an accountant nor a lead/lag expert, are you?

A. I'm not an accountant. I would say my expertise is in ratemaking. And, I think a lead/lag study and the application of it is essentially a component of the general topic referred to as "ratemaking".

Q. Have you ever developed a lead/lag study?

A. I have never actually developed one, but I have certainly reviewed them on a number of occasions.

Q. On Page 7 of your testimony, you question whether Northern's lead/lag study was conducted correctly. However, you don't actually conclude one way or the other. Is it your testimony that -- what is your testimony with respect to Northern's lead/lag study? Was it conducted correctly?
A. I disagree with the question. I do not question in my testimony the Company's lead/lag study. I'm simply saying that, beginning at Line 7 of Page 7, if the lead/lag study that was done in 2001 was conducted correctly, then the Company is fully compensated for the interest on the timing difference. That's all I'm saying.
Q. Have you conducted a review or done research on whether or not the lead/lag study that Northern uses in its COG was conducted properly?
A. Because I don't have a problem with it, I haven't done any research on it.
Q. Okay. So, you don't have that information?
A. I've reviewed the study, and it -- I've reviewed all the testimony that went with it in 2001. And, I find both the testimony and the results reasonable. So, that's why I have not raised an issue in this proceeding.

Q. Now, on Page 2 of your testimony, you indicate that the report that Staff filed on March 15th with the Commission recommends only a change to the accrual method for Northern's COG, isn't that correct?
A. Page 2?
Q. Yes.
A. Could you refer me to which line you're referring to?
Q. Let's see. Apologize. I apologize. It's Page 3. I have a different pagination here. Page 3, Lines 5 through 7, you indicate that the Staff report "recommends that Northern modify the COG by replacing billed revenues with accrued revenues derived by the gas utilized by customers each calendar month." Correct?
A. That's correct, yes.
Q. Okay. But I believe your testimony and the report also recommends a change in the rate to be applied to the working capital expense calculation, is that correct?
A. That's correct. The report itself only focussed on the reconciliation methodology, so it wouldn't have any recommendation with regard to the interest rate on working capital. That, the background to that, was also the Unitil and National Grid Default Service proceedings. And, because that issue was investigated

and the Commission addressed the issue in its two orders, Staff reviewed that issue when we reviewed the cost of gas filing, and made the recommendation that we're making in the testimony.
Q. Are you making the same recommendation in this case that you made in the other cases with respect to that particular rate?
A. A slight difference --
Q. What's the difference, Mr. McCluskey?
A. The difference is -- well, let me kind of back up a little bit. The two electric companies and Northern were and are using the overall cost of capital as the -- adjusted for taxes, as the carrying charge rate in calculating working capital. In the Unitil proceeding, Staff argued that that was not appropriate, because Default Service is essentially risk-free, it's fully reconcilable, and, hence, applying the overall cost of capital, which, obviously, has an equity component built into it, would be inappropriate. I have to say the -- I forget exactly what I recommended in the Unitil proceeding, whether I recommended the prime interest rate or argued that it should be the short-term debt rate, I forget. But the Commission issued an order which said they will go with the prime

rate as the appropriate carrying charge rate.

In this proceeding, I investigated the issue more and found -- concluded that, or "determined", I think is the best word, that Northern has what's called a "Money Pool". It's actually -- It's the NiSource System Money Pool, which all of the subsidiary companies, with the exception of three or four, deposit their surplus cash and can withdraw from the Money Pool to meet their short-term borrowing requirements. And, based on the research that I did, one of the purposes of the Money Pool is to actually finance each company's working capital. And, so, it seems to me that, if Northern is financing its working capital, including its gas supply working capital, through borrowings from the Money Pool, then it's appropriate to use the interest rate -- the Money Pool interest rate, which varies monthly. And, I believe that is a more cost-based rate to use than prime, which is several percentage points above the short-term borrowing rate from the Money Pool. So, I believe, given -- it's my understanding that Northern is financing its cash working capital with withdrawals from the Money Pool, then I believe it's appropriate to use that rate, rather than the prime, as the basis for

calculating their cash working capital costs.
Q. I think, Mr. McCluskey, you mentioned is one of the utilities where you recently examined this particular issue. And, do you recall what interest rate PSNH uses for its cash working capital?
A. I don't think I've said "I examined this issue with PSNH." I believe I said "it was raised in the Unitil proceeding", and I believe --
Q. I believe you spoke about PSNH's transmission?
A. In my testimony?
Q. I think you just did this morning, too.
A. Oh, I'm sorry. I don't believe I said the -- not this morning. I certainly said in my testimony that PSNH, yes, we are using -- let me back up. I believe what I address in my testimony, with regard to PSNH, is the reconciliation mechanism for their transmission expenses. And, the rate that PSNH is using to calculate the interest on the over-/undercollection is prime. If you'd like to draw my attention to where I address working capital for PSNH, I'd --
Q. Well, I'll just ask you now. Do you know what interest rate PSNH uses?
A. For its working capital?
Q. Yes.

A. For transmission?

Q. For whatever.

A. Well, it would vary. If a expense is subject to reconciliation, then the rate should be very different from something that is part of rate base.

Q. Do you know what rate it uses for its -- for the factors that do reconcile?

A. For cash working capital purposes?

Q. Yes.

A. I don't.

Q. You don't know?

A. No.

Q. And, PSNH has access to NU's Money Pool, does it not?

A. It does.

Q. Now, I believe, Mr. McCluskey, you indicated, I believe it's on Page 6 of your testimony, that Northern had not indicated why Staff's request to change to accrued revenues was inappropriate, isn't that true?

A. Could you give me the line reference please?

Q. I think you believe -- I believe you said, on Page 6, if you look at Line 14, starting on 13, "I am puzzled by the Company's opposition to Staff's recommendation and to Northern's inability".

A. Yes, that's what it says.

Q. But isn't it true that Northern informed you and Staff that accruing prospective revenues against actually incurred costs was a mismatch that it didn't agree with?

A. Certainly, in the discussions that we had, the Company did not agree with Staff's recommendation. The problem is, we could neither get from the Company's representatives as to why the accrued revenues was inappropriate or unfair to the Company. And, that is why after the end of the second meeting that we had, we requested that Northern make a proposal so we could examine it and critique it, but Northern declined to make such a proposal. So, we don't know why accrued revenues is unfair for a gas company.

Q. Well, didn't the Company inform you that the reason that it disagreed with your methodology was because of the large changes or swings in usage that occurred month to month, and that the likelihood of commodity cost price volatility and those large volumetric changes necessitated the methodology that the current cost of gas uses?

A. It is correct in that, during the discussions, Northern argued, never made a proposal, never demonstrated why, but they argued that, because there is significant variation in daily consumption, and hence revenues, as you go into the winter months, then they must be different, gas companies must be different from electric companies. But this -- it was never demonstrated over the winter period or an annual period that, because of that significant variation, the lag would be -- would be different from the lead/lag study, and the Company would not be compensated from its -- through its working capital adjustment. We've yet to see any demonstration, through a written document, as to why that is a problem for a gas company.

Q. You propounded discovery requests on Northern, have you not, on this issue?

A. I believe -- well, we did ask them for a proposal. That was essentially the last thing we asked them. And, we were informed essentially one week after a meeting that they wouldn't be submitting one.

Q. But you've asked the Company to provide you with information about this issue, and those data requests aren't due until Friday, isn't that correct?

A. We have got discovery out. I believe -- I believe almost all of those discovery questions relate to the 2001 lead/lag study, not to this particular issue. During the discussions, the Company did submit two analyses. And, in both cases, the first one, we were able to demonstrate that there was just a pure error in the analysis that they submitted. The second one hinged on taking consumption, and hence revenues, from the summer period to the winter period, which we just felt was, in order to reduce the interest, in order to demonstrate that the interest recovery -- which way would it go? That it would have the effect of reducing the interest. And, we just felt it was in -- that was an apples-and-oranges calculation.

Q. But isn't it true that the Company has been calculating the COG, i.e. applying the revenues that are collected in the beginning of the winter months that are attributable to summer usage, hasn't the Company been doing that for 30 some odd years?

A. Well, I'm not sure exactly how long it's been doing it. But, so have the electric companies, but that didn't stop the electric companies from analyzing the -- what we proposed and concluding that Staff is correct.

Q. Excuse me. Has Unitil had a default service component for 30 years?

A. They have had Default Service. They have had Transition Service. I didn't say they have had it for 30 years. I know PSNH has had reconciliation for power costs certainly as long as I've been working here.

Q. But PSNH's power costs were not something that you talked about in your prefiled testimony, were they? You talked about transmission costs, correct?

A. Okay. Well, let's stay with Unitil then. Unitil has Default Service now. They had Transition Service before that. And, before that, they had Power Service, which was fully reconciled. So, I suspect, although I don't know, that they were using the same methodology, the same mismatch of costs and revenues that they were using in Default Service, which they have now corrected.

Q. Are you saying that the electric companies have seasonal costs, such as the gas companies, where they have a summer and a winter gas costs?

A. It's certainly not as pronounced as for the gas companies, but there's variation from period to period. In fact, the gas company -- the electric companies essentially have four seasons. They have a pronounced summer period and they have a pronounced winter period, and they have off-peak periods in between.

Q. But, when the period ends, don't the costs get reconciled in the next period, not the next season?

A. I don't understand the question. What are you asking?

Q. I'm asking that, since the gas utilities have a summer COG and a winter COG, --
A. Uh-huh.
Q. -- are you saying that the electric utilities have similar costs or similar rates?
A. Yes. Unitil, it actually has two groups of customers. And, one has its rates set every six months, and they reconcile them every six months. The other group has its rates change every three months, and they reconcile every three months.
Q. Mr. McCluskey, do the electric companies have relatively flat loads?
A. Relative to gas companies?
Q. Yes.
A. I've said, "yes", but they're certainly not flat, and they vary from season to season.
Q. Don't electric companies right now, by virtue of the fact that they issue RFPs for their supply to serve Default Service, know pretty much with certainty in advance what their costs are going to be?
A. They -- Certainly, for the period of the request of the RFP. Once they select the winning bidder, they know what the unit prices are. The costs will, obviously, vary with consumption.

Q. Right. But you can't say the same thing for the gas companies, can you?
A. Well, if the gas companies don't hedge any of their requirements, then all of their purchases are subject to market prices. But there are components of the Company's portfolio that are fixed in nature, the capacity costs. So -- But, yes, I think I've agreed that there's more variation in consumption, which is what we were referring to earlier. And, also, in terms of cost, as you proceed through a particular peak or peak period, the prices are much less certain than for companies that are purchasing Default Service, because they are not purchased on a fixed price basis.
Q. Now, Mr. McCluskey, isn't it true that you're advocating that Northern can be distinguished with a lower return on its working capital just because its working capital is now associated with cost of gas rates -- that's now associated with the cost of gas rates, has been pulled out of base rates and put into a separate COG?
A. Yes. Because the Company's gas costs are fully reconcilable, the Company is essentially subject to effectively no risk on those gas costs.
Q. Isn't Northern subject to prudence reviews on its gas

purchases? Can it be?
A. Well, I don't know whether the Company is suggesting that it should be compensated for imprudent purchases. That would defeat the purpose of the imprudence finding, if it were to be compensated for that risk through its cost of capital.
Q. But it's not true that the Company is totally risk-free, in terms of being compensated for every gas purchase that it makes, is that true?
A. I'm not aware of any factor, other than imprudence, that the Company is at risk for with regard to gas costs.
Q. Now, isn't it true that Northern's purchases of gas supply are not affected by the fact that the working capital that's associated with gas costs has been moved out of base rates and into the COG rates, right?
A. Could you give me that question again.
Q. Sure. The fact that Northern -- The way that Northern purchases its gas or the way that it operates its business in going about buying gas is not in any way affected by the fact that now the COG rate contains a working capital factor, does it?
A. I'm sorry. You'll have to ask it a third time.
Q. Sure.

A. I'm really not getting that.
Q. Okay. Sorry. Isn't it true that Northern's purchases of its gas, the way it purchases gas, the way it operates, is not in any way affected by the fact that the COG rate contains a factor that's attributable to compensating the Company for supply working capital?
A. I think I understand your question now. I think you're essentially saying, the fact that the gas costs, both direct and indirect, have been unbundled, that doesn't affect the Company's procurement practices? I think the answer is -- I believe the answer is "yes", it does not affect it directly.
Q. Now, is it your understanding that Northern's lead/lag study has determined that the net lag days for funding gas purchases above collections is 6.33 days?
A. That's my understanding. That's the net result of that study, yes.
Q. Therefore, can't you conclude that gas purchases associated without lag days is a -- it represents a permanent condition relating to Northern's costs?
A. Could you ask me that question again.
Q. Can't you conclude that gas purchases associated without those lag days, without the 6.33 days, is something that is sort of a constant or a permanent

condition within the Company that relates to Northern's costs?

A. If you are -- If you are saying that there are certain gas purchases which have no lag associated with them? Then, I would say that is reflected in the study. I've reviewed this for other companies. Whenever they have special purchases, which have no lag associated with them, that has the effect of reducing the average lag. So, I would say it's already reflected in the net result.

Q. Mr. McCluskey, I'm just going to move onto a topic, I'll come back to that in a minute. What is the -- I believe, in the testimony that you gave today on the stand, you indicated that your methodology would result in an adjustment of the cost of gas rate that the Company is recommending in this filing, is that correct?

A. I believe it would reduce the interest charges that the Company would seek associated with the Reconciliation calculation.

Q. And, have you done a calculation of the amount of that rate adjustment?

A. Well, in my testimony, I do have some numbers, and they are based on data that the Company provided me. But I also note in a footnote that I suspect some of the consumption data is not reliable. And, if I could just find that. Do you have a reference where I say that?

Q. I don't. I'm sorry.

A. If you just give me a moment, I should be able to find it.

Q. Is it on the bottom of Page 8?

A. Yes. Okay. If I could just review this for a moment, and then I'll tell you what I think is the net effect. Well, I'll make it easier on myself. I'll refer to the two attachments that are submitted in the -- that were attached to the report. So, it's Attachment 1 and 2 to the report, Exhibit 2. And, there we're talking about the -- we're talking about the annual period May 2005 through April 2006. Using the Company's current methodology, produces carrying charges equal to $264,222. You can see that at the far right of the exhibit.

Q. Right. And, I'm asking you, Mr. McCluskey, what -- have you plugged any of the financial analysis that results from your methodology into the Company's filing to come up with a new COG rate for the Summer Period 2007?

A. I haven't. All I'm doing here is trying to give you an order of magnitude of the impact.

Q. Right. But your testimony doesn't tell the Commission what rate to put into effect, does it?

A. It doesn't, because typically what happens is, if there's some methodological change required by the Commission, the Commission will direct the Company to submit a compliance filing consistent with that. And, so, it's the Company's role to develop the rate based on the methodology that the Commissioners think is appropriate.

Q. Mr. McCluskey, turning to the question I was trying to ask you before. I believe your testimony was, in your prefiled and this morning, that the Company's lead/lag study indicates that there -- that it is to be compensated for a net 6.33 days, 6.33 days worth of revenue, if you will, in its working capital. Is that correct?

A. That's correct.

Q. Okay. So, if this is in the lead/lag study and this has been accepted, and if the Company is experiencing, on a permanent level or on a consistent level, the cost associated with funding 6.33 net lag days, then isn't that particular cost the same or similar to other factors that are financed through the long-term borrowing rate?

A. If the Company was financing that short-term lag, we're talking about 6.33 days every month, if that's not a short-term borrowing requirement, then I don't know what is. If that's being financed with long-term debt or equity, then the appropriate rate would be the overall cost of capital. It's my understanding that the Company is financing that short-term borrowing requirement through the Money Pool. Why? Because the Company, not just in New Hampshire, but in Massachusetts and in Maine, has testified, in fact, has submitted the Money Pool Agreement itself, which states explicitly that one of the purposes of the Money Pool is to finance the Company's cash working capital.

So, I could turn it around and say, "if the Company is not using the Money Pool to finance its cash working capital, and incurring some significantly higher cost, then why would it do that? Why would it avoid using the Money Pool at a rate which is almost half the overall cost of capital?" It makes no sense.

MS. GEIGER: Thank you. I have no further questions.

BY CHAIRMAN GETZ

Q. Good afternoon, Mr. McCluskey. I just had -- I wanted to follow up in one area, and it's really just to get a general articulation of your view of the relationship of your proposed change in methodology to the status quo. The basis for your position is that they use the billed revenues in calculating the cost of gas reconciliation is that that results in an overcollection. And, you're suggesting that we alter the methodology to use accrued revenues, instead of billed revenues. That's a fair characterization of your --

A. Yes. It results in an overcollection, because they also have a working capital adjustment. If the Company did not have a working capital adjustment, there would be no issue here. It's the fact that they have this other mechanism that appears to be compensating them for the same timing difference that's reflected in the reconciliation calculation that raises the issue of overcollection.

Q. But both of these mechanisms have been in place, and this has, according to, as I understand the Company's position, this has been the methodology that's been applied for 30 years, and they don't agree that there's a double recovery. So, they would say "let's just keep the status quo." Is that your understanding of their

position?
A. Yes. They say "it's been in place a long time." But things do change.
Q. Well, that's what I want to try to get, if you could try to express it for me. It seems there's at least a few ways of looking at this. Either the existing methodology was flawed from the beginning or that it masked some changes or that the effects were so small that it really wasn't worth drilling down into it. Or, another way I guess could be that what occurred is that over time something changed to invalidate the old approach, or -- and I guess some combination. That you just have come up with a more refined or a better way of addressing the issue and looking at the relationship between the cash working capital and the reconciliation mechanisms. But can you just draw from among those, those choices? What's the best way, in a general sense, of formulating your position of why we need to change the current approach?
A. First of all, I don't believe there was a deliberate attempt on the part of gas companies or electric companies to overcollect. I think this -- it's quite possible, and I really don't know, but it's quite possible that the two rate components were developed

separately, and there just wasn't a realization that they were recovering for the same expenses. And, it wasn't until Staff was reviewing the interest calculation for Unitil, and, in that very same proceeding, Commissioner, you remember -- you recall that we were also addressing the cash working capital calculation. And, it was because Staff was looking at both methodologies, we were fully immersed in it. And, it was simply because we were looking at the two at the same time that it dawned on us that "aren't these two things doing the same thing?" And, we proposed that to Unitil. And, after some thrashing around, we came to a meeting of the minds that it was. So, I think that's essentially -- this could have been happening for ten, twenty, thirty years. Who knows. But sometimes things happen like that, because they are constructed independently, without an understanding of how they interact.

Q. But, over that period of time, I assume there's various -- that the leads and lags changed over time and overcollections and undercollections changed over time.

A. (Witness nodding affirmatively)

Q. So, would it be possible to conclude whether ratepayers have been consistently adversely affected over that period or is it your position that's really just irrelevant? What you've now discovered is what you see is some inherent flaw that just needs to be changed?

A. I think it's the latter. We just need to correct the thing going forward. We don't want to look any further back than the reconciliation period. That's water under the bridge. We just need to -- Staff believes that we need to get it corrected going forward. As to whether customers have benefited or been harmed through this, it's hard to say exactly how it all falls out. But, given how this first month begins, if you recall the discussion I had ten or fifteen minutes ago, there's a tendency, because the Company, under its billing approach, there's a tendency for the Company to reflect already a portion of the monthly revenues in that first month. And, that's -- the effect of that flows through for the subsequent five or six months. That I feel confident saying that that has generally worked against customers. But who knows what the true net effect has been.

CHAIRMAN GETZ: Okay. Thank you. Any redirect?

MS. ROSS: I have just one.

REDIRECT EXAMINATION

BY MS. ROSS

Q. Mr. McCluskey, you were asked a little earlier by Ms. Geiger about some outstanding requests of Northern with regard to its 2001 Lead/Lag Study. And just, it's true, isn't it, that Staff's real concern with Northern's Lead/Lag Study is that KeySpan has a much larger lag as a result of its -- a dramatically larger lag as a result of its lead/lag study. And, that Staff's real interest in Northern is merely understanding the two studies, so it can determine why there is such a wide difference between the two?

A. Yes. I want to reiterate, Staff has no concern with Northern's lead/lag study. If Northern believes that it's not fully recovering their working capital costs, then it's free to submit a revised proposal, just like KeySpan and just like Unitil has done, and the Staff will review it. But we currently have no concern with their study. We are simply asking the Company discovery on that 2001 study to form the basis for the review that we're conducting with regard to KeySpan, who has a net lag of in excess of 20 days. And, so, there's a significant difference between the two companies. And, we want to understand why that's the case. And, Northern has agreed to respond to those questions and provide us some kind of a base on which to do the KeySpan analysis.

Q. Mr. McCluskey, if Northern accounted for its gas costs on a cash basis, i.e. when it actually paid for the gas consumed, similar to the way it treats collections, would this double recovery exist, if it did that in its reconciliation mechanism?

A. You're proposing a cash basis for costs and revenues on a billing basis?

Q. Right.

A. I'd have to -- I really don't know the answer to that. I'd have to study that, because we've still got the working capital adjustment. I'd want to see whether there was some -- still some interaction between the two mechanisms. But that's something I haven't considered. I think, using accrued costs and revenues eliminates the potential mismatch problem and leaves the working capital calculation in place.

MS. ROSS: Thank you. I have no further redirect.

MS. GEIGER: Mr. Chairman, may I ask a quick follow-along question please?

CHAIRMAN GETZ: Please.

RECROSS-EXAMINATION

BY MS. GEIGER

Q. Mr. McCluskey, do you know why Northern's lead/lag study produces a different result than KeySpan's lead/lag study?

A. I think the KeySpan lead/lag study has a lot to do with KeySpan's collection practices. They don't collect the revenues very quickly, compared with Northern. That appears to be the case. I don't think the leads are substantially different between the two companies. But, certainly, the collection practices result in a very different outcome.

Q. Do you know whether KeySpan's lead/lag study reflects average annual customer and company payment behavior?

A. I believe they do. I believe it does.

Q. Do you know whether Northern's does as well?

A. The lead/lag study?

Q. Yes.

A. Northern's is an annual calculation. Certainly, the lag is. It's an average of 12 months of accounts receivables.

MS. GEIGER: Thank you.

CHAIRMAN GETZ: Anything further for this witness?

(No verbal response)

CHAIRMAN GETZ: Okay. Thank you. You're excused, Mr. McCluskey.

MS. GEIGER: Mr. Chairman, would it be possible to take a five minute break before Mr. Ferro takes the stand?

CHAIRMAN GETZ: Let's -- Can you use fifteen?

MS. GEIGER: Sure.

CHAIRMAN GETZ: We will resume at quarter of one.

MS. GEIGER: Thank you.

(Recess taken at 12:28 p.m. and the hearing reconvened at 12:47 p.m.)

CHAIRMAN GETZ: Okay. We're back on the record with Mr. Ferro's rebuttal testimony.

MS. GEIGER: Yes.

(Whereupon Joseph A. Ferro was recalled to the stand, having been previously sworn.)

JOSEPH A. FERRO, PREVIOUSLY SWORN

REBUTTAL DIRECT EXAMINATION

BY MS. GEIGER

Q. Mr. Ferro, I remind you that you're still under oath. And, I'm going to be showing you a document that the

Company has prefiled with the Clerk for identification as "Exhibit 4". And, ask you to identify it please.

A. This is the filing of my rebuttal testimony to Mr. McCluskey's testimony. We submitted this testimony on April 20th, 2007, and that's what the cover letter is dated. And, again, it was rebuttal to Mr. McCluskey's testimony filed on April 16, 2007.

CHAIRMAN GETZ: Let's take a second then. Let's just get our numbering correct. I think we went to Exhibit 5 for Mr. McCluskey's testimony?

MS. GEIGER: Right. But I don't believe 4 ever got --

CHAIRMAN GETZ: And, we never mentioned 4? Okay. All right. So, then, the rebuttal testimony will be "Exhibit 4".

(The document, as described, was herewith marked as Exhibit 4 for identification.)

MS. GEIGER: Does the Bench have copies?

CHAIRMAN GETZ: Yes.

BY MS. GEIGER

Q. Mr. Ferro, was what's been marked for identification as "Exhibit 4" prepared by you or under your direct supervision and control?

A. Yes, it was.

Q. And, do you have any changes or corrections to make to Exhibit Number 4?

A. I have a few minor ones.

Q. Could you please proceed to run through them?

A. Certainly. On Page 9 of the testimony, as we were, you know, somewhat in haste putting together testimony to meet the April 20th deadline, some things, some words went astray. On Line Number 7 it says "In the New England", this should read "For most, if not all New England gas utilities, the gas cost component" insert "of working capital is severed and included in the cost of gas adjustment mechanism as a gas cost."

Q. Then, Mr. Ferro, on Line 7, I think you said "cost" -- you changed "CGA", is that correct?

A. Yes, I changed the "CGA" to "cost of gas adjustment mechanism".

Q. Thank you.

A. Then, my next change would be on Page 17, Line 14, fourth word in, the letters got transposed, it's, instead of "sue", it's "use". Then, on Page 19, on Line 2, just before the end of the line, there's a hanging "t" there. That should be deleted.

And, then, finally, on my schedules,

it's really JAF Schedule 1 that I state in my testimony. The pages got labeled "Attachment JAF-1". It really is "Schedule JAF-1", Pages 1 through 4. And, then, finally, on Page 4 of 4, of Schedule JAF-1, some of the words describing what this schedule was trying to do was truncated at the end on the right, so we lost a few words.

MS. GEIGER: And, Mr. Chairman, with your permission, what I'd like to do is provide the Bench with copies of that page that Mr. Ferro just referred to, just so that you'll have a complete -- complete wording of the narrative at the top of the page. And, I'll provide a copy to the Clerk. And, would merely ask that this page be substituted for the page that currently exists in Exhibit 4, at the very end, so that it's more complete.

CHAIRMAN GETZ: Okay. We'll make the substitution.

MS. GEIGER: Thank you.

BY MS. GEIGER

Q. Now, Mr. Ferro, with those changes and corrections in mind, if you were asked the same questions today, would your testimony and answers be the same?

A. Yes, they would.

Q. And, could you please summarize for the Commission whether you agree with Staff's conclusions as provided by Mr. McCluskey in his prefiled testimony? And, if not, why not?

A. Yes. I do not agree with Staff and Mr. McCluskey's position in changing the current mechanism of calculating interest on the monthly under-/overcollection balances. In that, I think it's absolutely appropriate to continue using actual billed sales to match against actual purchased gas costs. If you bear with me, just let me give you a little background. Cost of gas adjustment mechanisms were created in the early 1970s. And, of course, they were created because before the Company used to have all its expenses, if you will, revenue requirement, in base rates. And, at that time, in the late '60s, '60s, the gas costs were rather stable, and the Company could maintain their base rates for a reasonable amount of time without having to file a rate case.

Well, as gas costs became less stable, the practical thing to do was to pull gas costs out of base rates and create a cost of gas mechanism, because, otherwise, the company will be filing rate cases every year practically. That happened in the early 1970s. The cost of gas mechanism was designed to recover actual costs on an ongoing basis, as you incur costs, you recover them.

Flashing ahead to the mid '90s, the companies, as I stated in my previous testimony, were unbundling and started to take out, out of base rates, all revenue requirement associated with providing gas supply service. An example was bad debt expense associated with gas costs. Another example is the portion of the revenue requirement associated with the LNG and propane plants associated with providing gas supply that typically or historically were in base rates. And, the other one was working capital expense on purchased gas costs. It was recovered in base rates, all working capital, for the distribution side of it and the gas supply side of it, were recovered in base rates.

So, we unbundled. And, it became a little more transparent, the working capital expense we were recovering associated with gas costs through the cost of gas mechanism. However, that did not change the conditions under which we recovered working capital, in that we still were recovering all the working capital expense. And, just a piece was extracted to make sure that we did not overcharge "transportation only" customers, get it out of base rates, because base rates are charged to transportation customers and to bundled sales customers. And, furthermore, because it was in a cost of gas, it was designed to track actual gas costs as you go forward, working capital expense on actual gas costs. And, so, the intention of a cost of gas mechanism always has been, I'd like to think always will be, is to track actual costs incurred, and, as Mr. McCluskey said, the prudently incurred costs should be recovered.

Now, on the flip-side, the lead/lag study that was talked about earlier, that is a study that leads into or results into a working capital expense associated with purchased gas costs. And, that lead/lag study is based on an annual test year period, take an annual total and determining the difference in the payment behavior of Northern or a gas utility's customers versus Northern's payment behavior or practice, if you will, of paying the gas suppliers and the pipelines.

Northern's lead/lag study, its latest one, I think it was the 12 months ended June 2001, was filed in docket DG 01-182, which resulted in a 6.33 net lag days. That's simply capturing, again, the difference between the Company paying its suppliers and pipelines versus the customers paying Northern for its bills. It does not in any way capture on a month-to-month basis any difference between the actual costs that the Company incurred versus the actual revenues the Company bills out.

Certainly, whether it's the test year period for the lead/lag study or a 12 month period for calculating interest on under-/overcollections, after the 12 months, the volumes that drive the costs are virtually the same as the volumes that drive the revenues, after 12 months. But, from month-to-month, they are quite different. And, that's certainly one reason why, it's because we have temperature-sensitive load, and we bill our customers on a cycle billing basis.

So, the interest on a deferred calculation or the under-/overcollection compliments the lead/lag study or the working capital expense, in that the working capital expense captures something else. The working capital expense captures the difference in payment behavior, while the interest on the deferred tracks actual, the actual gas costs versus the actual revenues.

[Witness: Ferro]

The actual month-to-month mismatch creates either actual borrowing costs or needs, if you will, or sometimes our revenues are higher on a monthly basis than our costs, and it demonstrates that we have use of our customers' funds, use of the customers' dollars. But, again, if our load was flat, then the Company would be totally indifferent to going along with Mr. McCluskey's proposal of doing accrual accounting, because the revenues and the costs would be generated on the same volumes, and there would be no volume mismatch. I want to emphasize that the Company's interest on the under-/overrecoveries does not reflect any net lag days. It's just every month we calculate interest on the under-/overcollection, based on 30 days of revenues and 30 days of costs. Its actual 30 days of costs, actual 30 days of revenues. And, again, the cost of gas is designed to recover actual costs.

Now, Staff's recommendation of using calendar month volumes or accrual revenues, which in itself is sort of like an estimate, takes away or ignores the actual monthly mismatch. And, that really is undoing the intention of the cost of gas mechanism, you want to reflect actual activity.

The other thing about the Staff's proposal is that they want to advance the revenues through a calendar month for accrued revenues, advance the revenues, some of which we haven't even read the customers' meters yet. Some of which, therefore, we haven't even billed the customers. But those are the revenues that is proposed to be reflected in the cost of gas calculation for interest.

That's my basic summary.

Q. Mr. Ferro, is the Company overcompensated by the current COG methodology?

A. I believe definitely not.

Q. Okay. Now, Mr. McCluskey said that "working capital" -- he testified this morning that "working capital rate adjustments compensate the Company for interest on the cost of financing the net lag between the Company's payment of its gas costs and the receipt of its revenues." Do you agree with that?

A. Yes.

Q. But does interest on the monthly under- and overcollection balance reflect any net lag days?

A. It does not. No net lag days are reflected in the calculation of interest on the under-/overcollections.

Q. Okay. Now, were you here this morning when

Mr. McCluskey testified about the Company's risk with respect to its ability to recover its gas commodity costs?

A. Yes, I recall.

Q. And, do you -- what do you recall about that testimony? What do you believe Mr. --

A. Yes. I recall Mr. McCluskey said "I don't know any other reason why the Company would not be able to recover its costs other than for imprudent actions." Well, first, that's the point. That the Company is not risk-free of recovering its costs, because some actions could be deemed by the Commission to be imprudent. And, those costs would not be recoverable. So, it's not "risk-free". But, beyond the imprudence, I only have to go back to less than two years ago, where, in docket DG 05-080, Northern Utilities' shareholders had to absorb $200,000 of demand or fixed capacity costs to settle the proceeding in the Modified Proportional Responsibility docket. So that in itself was another example of these costs are not risk -- the recovery of these costs are not risk-free.

Q. Now, Mr. Ferro, how long have you been calculating gas costs?

A. I started with Bay State Gas in April of 1977, in the

Customer Relations area, doing billings and dealing with CGA rates, too, and moved to the Rate Department in September 1980. And, one month later, I was filing cost of gas adjustments with the Massachusetts and I believe New Hampshire Commissions.
Q. So, this is over --
A. Well, I guess that makes it approximately 16, 16 and a half -- I'm sorry, 26 and a half years or so.
Q. Okay. And, have you been calculating the COG in a similar fashion as the way the Company has proposed the rate in this filing?
A. Certainly, in my direct firsthand experience, we've been calculating cost of gas rates similarly, insofar as we track the under-/overrecoveries based on actual billed sales and revenues versus actual cost, and calculate interest on the balance. That's been the case in Bay State Gas, in Massachusetts, and Northern Utilities in New Hampshire and Northern Utilities in Maine.
Q. Do you have any additional comments that you'd like to make in response to Mr. McCluskey's oral testimony provided at today's hearing?
A. I do. First, I think Mr. McCluskey said that "costs are reflected in the interest on the under-/over based

on an accrual basis. Well, costs are reflected on an actual basis. And, let me define "actual". "Actual" is the Company recording its costs and revenues at the end of the month for everything it has either billed out or been charged, and those are actuals. So, the costs, in my thinking and in my view, are not accrued, they're actual costs. Just as the revenues are reflected on an actual basis.

Another point I want to make is that Mr. McCluskey turned to Attachment -- I believe Attachment 1 and Attachment 2 of the Staff's report. And, if I could turn to that, that page of Attachment 2, what's strikingly missing from that Attachment 2 is that -- I'm sorry, Attachment 1, I stand to be corrected, Attachment 1, is that, in November '05, they show -- we show billed revenues that's a half month of prorated revenues for the winter period. While, in the meantime, the Company is recording a half month of revenues in the summer account, matched against zero costs, because there's no costs in November associated with the summer period. So, this result would change significantly if you reflected the actual complete revenues that the Company is recording each month, and, in particular, in this case, November '05. As I stated earlier, the Company every single month records 30 days of revenues and 30 days of costs.

Another comment that I want to make on Mr. McCluskey's oral testimony is we were talking about the interest rate to be used. And, Mr. McCluskey apparently is proposing to use the short-term borrowing rate for the calculation of working capital expense. First and foremost, as my testimony states, the Company, on two accounts, disagrees with that. The first account is that the Company, as I said, the cost of gas is designed to recover the actual costs. And any costs that need to be funded on a permanent basis, like 6.33 net lag days of purchased gas costs, that is a permanent, constant, long-term position. Those costs are funded based on long-term borrowings, not short-term borrowings, just like its other operations. And, to speak to that, the financial community or lenders would not expect to get a short-term borrowing rate on some permanent position of costs. And, again, we look at an annual basis in a test year, come up with 6.33 net lag days, that's representative of the ongoing long-term position of the Company. So, I believe that that is misdirected to change the interest rate. But,

[Witness: Ferro]

in particular, there was some discussion on the Money Pool, in that the Company use its short-term borrowing rate for its Money Pool, that's absolutely correct.

The Company switched from a BANOR financing vehicle to the NiSource Corporate Services Money Pool fund. And, it was -- it uses the short-term to finance inventory gas. Now, inventory gas is withdrawn from inventory every winter season. So, that's an ongoing, short-term borrowing of that gas supply. But, again, purchased gas costs, at a 6.33 net lag day, represents a permanent long-term position of a need to fund purchased gas. So, that they're two different animals.

I also want to comment on the fact that the Company has discussed with Staff, in its technical sessions, that it disagrees with the accrued revenues, that it was inappropriate to go to accrued revenue. The Company has emphasized that what the -- what the deferred gas cost calculation does is it captures the volume mismatch, call it a "volume lag", because it's not a lag in days. The actual volume lag or volume difference between the volumes that generate the revenues versus the volumes that generate the costs, we've expressed that at least in the last couple of discussions with Staff.

If we had a, and I think I'm repeating myself here, but if we had a flat load, whether it's for the -- like the electrics have maybe a flatter load than us, who knows. But, if we had a flat load, we would be absolutely indifferent to this proposal, because we wouldn't have this monthly volume mismatch that generates costs and revenues.

So, essentially, the interest on the under-/overcollection balances captures something entirely different than the lead/lag study and the resulting working capital expense captures. One captures the difference in payment habits, the other captures the actual operations of the Company's gas cost activity, sales and associated revenues, versus sendout and associated costs.

And, one final thing I do want to state, it is in my testimony, but I did file schedules. And, I want to say I filed schedules because, quite frankly, there is a concern, and even a sensitivity, that, well, you know, most of my discussions here are somewhat qualitative and not completely quantitative. And, that the Commission might need to see some numbers of what's going on. Well, first and foremost, neither side, if you will, has produced any numbers. But what I've done is I've tried to at least follow the script and calculate what the interest on the under-/overcollection balances is generating, the actual working capital expense is generating, compared to some interest needs to a cash flow analysis, using the 6.33 net lag days. That's what these schedules do. And, so, if you turn to Page 4 of that schedule, which is the very last page of my exhibit, or Northern's exhibit. And, as I state in my testimony, it's somewhat inconclusive. Let's go down to the bottom section. And, it shows that, using "Calendar Month", you have interest recovery of "$95,656", the second last line, and the cash flow analysis on the previous page shows a need of "$109,995 in interest. That shows that we're under recovering, if you use calendar month accrued revenues, by about $14,000. And, then, I looked at "Billing Month". And, "Billing Month" shows that I'd be generating "141,595", more than the "109,995". And, it shows that I'd be over recovered by 31,600. Quite frankly, I don't know what really that's telling us, other than that this is an analysis that one is trying to model. That's not really that -- that conducive to modeling. You know, it can go either way.

And, that I just wanted to and felt obligated to present some numbers at this hearing.

But I do want to say, and I said in my testimony, that what disturbed me is that, in the Unitil case, and I'm not privy to much of what was going on there, but I was quite understanding of the fact that the analysis that led the parties to conclude "well, jeez, we should use accrued revenues on a calendar month basis", was based on a hypothetical, simplified example. That showed each day, in each month, that purchased volumes, with exactly the same as sales volumes that generate the revenues. And, that's precisely why we need to continue calculating interest on under-/overcollections using actual sales volumes versus actual costs, because those volumes aren't the same every day, they're not the same every month. And, in fact, when you're going from a warmer month to a colder month, there's a drag on those volumes that create a revenue or a borrowing need that's not reflected in the working capital calculation. That, again, just reflects the payment behavior difference between us paying our suppliers and the pipeline versus how our customers pay us for the billings.

Q. Mr. Ferro, do you have anything else that you would like to add?

A. No, I thought I did, but, at this time, I don't.

MS. GEIGER: Thank you.

CHAIRMAN GETZ: Ms. Ross.

MS. ROSS: Thank you. Good afternoon again, Mr. Ferro.

THE WITNESS: Good afternoon.

REBUTTAL CROSS-EXAMINATION

BY MS. ROSS

Q. At several points during your testimony today, you've talked about the fact that the cost of gas mechanism has been in place for 30 plus years. But it's true, isn't it, the cost of gas mechanism has changed and evolved throughout it's entire 30 year history?

A. In what way?

Q. Well, for instance, the Professional Responsibility Agreement that dealt with capacity charges between New Hampshire -- I'm sorry, the Proportional Responsibility Agreement between Maine and New Hampshire impacted the cost of gas mechanism, didn't it?

A. It did not really impact the cost of gas mechanism, it just determined the level of demand costs that were allocated between the two divisions.

Q. And, the financing tool that was used to fund your reconciliation needs changed from the use of an earlier financing tool, I think it was referred to as "BANOR" or "BÁNOR" to the Money Pool, is that also correct?

A. Certainly. That reflected more actual costs, that's right. The operative word is "actual".

Q. And, then, the unbundling and shifting of indirect gas costs from base rates to the cost of gas rates also changed the cost of gas mechanism, didn't it?

A. Again, as I explained in my prefiled -- in my oral testimony, reflecting actual costs, in an unbundling, it removed the actual costs associated with providing gas supply service from base rates into a cost of gas mechanism.

Q. And, then, again, the current filing, changes to the SMBA method for calculating the cost of gas, which is another change in method, isn't it?

A. That's a method of allocating costs between classes, yes.

Q. So, my statement earlier is true, isn't it, that the cost of gas mechanism has changed and evolved fairly constantly throughout its history?

A. What has not changed, and is fundamental to the cost of gas mechanism, is you match actual costs with actual revenues, and that's the reconciliation, and you calculate interest on the balances each month on those differences. That has not changed in over 30 years.

Q. And, it's also true, isn't it, that there are state-to-state variations in the cost of gas mechanism?

A. I am most familiar with Massachusetts, Northern -- New Hampshire, and in Maine.

Q. Well, for instance, in Maine and New Hampshire, doesn't the rate of interest on the reconciliation differ with Maine using the short-term debt rate and New Hampshire using the prime rate currently?

A. I'm glad you mentioned that. Certainly, short-term borrowing rate does reflect more of the Company's costs of funding the monthly under/over recovery balances. The Company, Northern Utilities, would have no problem at all if Staff or the Commission wanted to change using the prime rate to the short-term borrowing rate in its under-/overrecoveries, because that is the closer, more representative cost of the short-term borrowings of monthly swings. It's not the actual cost of funding of more long-term gas cost position, i.e. 6.33 net lag days of annual purchased gas costs.

Q. Mr. Ferro, you've stated repeatedly that the calculation of interest related to the monthly balance of over- or undercollection doesn't incorporate any net

lag days, and you've also repeated many times that the calculation shows 30 or 31 days of actual billed volumes. And, I'd like to refer you to your own Exhibit JAF-1, and ask you a couple of questions on it.
A. I'm there.
Q. Yes. If you're looking in November in this exhibit, and you're looking at your winter period cost of gas, "Cost of Firm Gas", that number is "5,142,673". And, then, if you look at "Reported Collections", that is "1,611,166", correct? And, under it there's actually a note, it says "prorated month", is that correct?
A. That's correct.
Q. Now, that is not 30 days of billed revenue, is it, Mr. Ferro?
A. That's correct. If you turn to the next page, the over 15 days has shown up in November '05, in the summer period, of "1,950,004".
Q. Yes. But the fact that it doesn't show in this table, which is the table we use for calculating the interest on over and under recovery, means that there isn't -- it's shown as a deficiency, isn't it, Mr. Ferro, for purposes of reconciliation or an undercollection?
A. No, not true. Because, also in the summer account, we're reflecting a million nine of revenues against no

costs. And, the customer gets the benefit of a half month of revenues matched against zero costs in the exact same month that you're talking about.

Q. But you ignore that number when you calculate your winter cost of gas and you calculate your interest earned on it, don't you?

A. You can't separate summer and winter when you're talking about total -- total interest calculation on under-/overrecoveries. We're calculating, and you'll see it when we file the summertime, that we've received some revenues in a month without any costs. I don't understand the question. I don't understand the problem.

MS. ROSS: I'm going to ask Mr. McCluskey to follow this one.

MR. McCLUSKEY: Thank you.

BY MR. McCLUSKEY

Q. If we could just focus on the Page 2, for the summer period. You're saying there that you've got the other portion of November in the first column, $1.95 million?

A. Correct.

Q. And, we also have November to the right of this?

A. That's correct.

Q. So, how many Novembers have we got in this annual schedule?

A. Well, as you look, you have the same -- you have the same revenues -- can't find the line here -- you have the same revenues, 10,124,000, that match the costs, both in calendar month and billing month.

Q. Okay. Mr. Ferro, have you added up the revenues that you're showing from May through November?

A. Yes.

Q. And, have you determined whether they equal the $10 million without the $1.95 million? Have you done that calculation?

A. No. The schedule shows the total column.

Q. I know what the schedule shows. But have you actually determined whether the 1.95 million is reflected in the total of 10.124?

A. Did I manually add it up? No.

MR. McCLUSKEY: Thank you.

BY MS. ROSS

Q. Mr. Ferro, I'd like to turn to another statement that you've made repeatedly. And, that is that you reflect actual costs in the month that they're incurred.

A. That's correct.

Q. And, Mr. Ferro, if we take November, for instance, in this schedule, and you show the "5,142,673" in gas

costs.
A. I'm sorry, which --
Q. That's your -- I'm going back to Page 1 of your Schedule 1 that we were just looking at.
A. All right.
Q. And, the November winter period cost of firm gas, "5,142,673", do you see that number? It would be line -- no, the lines aren't numbered. Sorry. It's under your "Billing Months" heading?
A. Okay.
Q. First column.
A. First column. What number did you say, I'm sorry?
Q. The "5,142,673".
A. Okay. I'm sorry. Yes.
Q. I'm probing what you mean by "actual". The "5,142,673", as I understand it, is the cost of the gas consumed in that month, is that correct?
A. Well, I defined "actual" in my oral testimony. And, the "actual" -- "actual" means that these are the costs that are based on actual readings that are being billed by the suppliers to the Company.
Q. So, those are units of gas that were consumed --
A. Well, certainly, it was consumed --
Q. -- in November, and measured at the end of the month or

sometime before the end of the month?
A. At the end of the month, certainly.
Q. Okay. Measured at the end of the month. Now, when those volumes of gas are measured, how long does it take the supplier to bill you for those volumes, on average?
A. I don't have it in front of me, but that's reflected in the net lag days with respect to the 15.2 lead days of costs and the 15.2 lag days in revenues are part of the analysis that gets to the 6.33 net lag days. So, there is no lag days reflected in this calculation.
Q. Well, you're reflecting costs in the month of November that aren't going to be billed until late December, isn't that correct?
A. No. This is at the --
Q. I'm sorry, they won't be paid until late December. My understanding is that your gas supply costs that you incur in November are, actually, there's about a lag of 40 days till payment. So, there's a lag till you're billed and then there's a lag till you pay -- I'm sorry, we have referred to it as a "lead".
A. Yes. And, that's reflected in the lead/lag study.
Q. Okay.
A. The net lag days.

Q. Okay. So, when I -- my point is, you are calling these costs "actual costs", but those costs actually aren't paid until late December, correct?
A. Just as our revenues aren't paid until sometime well in the future.
Q. The revenues are not received until later?
A. Well in the future.
Q. Six days later than you pay, on average?
A. Sure.
Q. Okay. So, that's just to clarify that, when you talk about "actual costs", you're talking not about payment of costs, but you're talking about when they're accrued or when you become obligated to pay?
A. Correct. None of this is on a cash basis. The actual, whether they're revenues or costs, is not on a cash basis. It's on actual meter readings and sending out the bills.
Q. And, then, again, Mr. Ferro, when you use the term "actual" with reference to your revenues, you mean a 15 day billing lag, which is why you only show half a month of revenues in November, correct?
A. I'm sorry, but I have to still state I show the full month of revenues in November. We billed -- We bill the customers in November for 30 days of use throughout

the month. Cycle 1 customer gets billed 29 days of usage in October, one day in November. A Cycle 19 customer, say, we have 20 cycles in a billing cycle, that customer gets billed one day of use in October and 29 days in November. Those are actual billed revenues. That's what the Company is billing out, that's what the Company is trying to receive or get payment for.

Q. Mr. Ferro, you've taken the position in your testimony that "the lead/lag study cannot be adjusted for differences in billing due to the broad volumetric changes that occur from summer to winter gas seasons." Is that correct?

A. I'm not aware of a methodology that would be able to capture that. But, certainly, that's correct that it doesn't attempt or contemplate the monthly mismatches or the monthly delay revenues versus costs or the monthly advancement of revenues versus costs. It just takes a look at an annual average of volumes driving costs and volumes driving revenues. And, as I stated earlier, those volumes, on an annual basis, are essentially equal. It's on a monthly basis that there is ups and downs.

Q. Mr. Ferro, I'm going to show you a copy of a page that is out of your lead/lag study. It was an exhibit in docket NU DG 01-182. And, this deals with the revenue lag in that study.

A. I'm sorry. I believe you must have given me the wrong piece of paper.

MS. GEIGER: Yes, I --

THE WITNESS: This is the cost of gas schedule in this current docket that was calculating the CGA rates.

MS. ROSS: Oh, sorry. Excuse me.

(Atty. Ross handing document to the witness.)

MS. ROSS: Here you go. Sorry. I apologize, Commissioners. I have one copy of this right now. I would like you to see it.

(Atty. Ross handing document to Chairman Getz.)

BY MS. ROSS

Q. Okay. This is a report, obviously, not filed by you, this was filed by another witness. But I would -- I'm referring you to it because I would like you to take a look at the "Gas Receivables" column. And, the test year is shown to the left of month-by-month. And, just take a look at the amount of variation in the receivables amounts as you go from month-to-month, with

a low of "431,000", I don't know if this is in thousands or in dollars, and then a high of "8,219,790". Do you note that?
A. I see that, yes.
Q. So, clearly, the lead/lag study did consider the fluctuation of receivables in its -- in its development?
A. It did not. It just took the total and took a monthly average, and then took a daily average. It did not take into consideration the monthly differences, it took the total.
Q. And, those variations reflect the usage variations, do they not, from month-to-month?
A. The variations have no impact in this calculation. It's the total that impacts the calculation. The result would have been the same if those receivables were exactly the same each month and totalled up to "45,803,490". That's one of the points I was trying to make.
MS. ROSS: I have a couple of follow-on questions with Mr. McCluskey.
MR. McCLUSKEY: Thank you.
BY MR. McCLUSKEY
Q. Mr. Ferro, if I could refer you to Schedule JAF-1-1 --

sorry, 1, Page 1.

A. I'm there.

Q. I want to focus on the revenues or what you call "Reported collections". Under the accrued revenues calculation or calendar months, for the month of January and February, okay?

A. Yes.

Q. January is in excess of $12 million?

A. Yes.

Q. February is $3.3 million, okay? Do you recall a discovery request to the Company from Staff questioning whether revenues of those magnitudes accurately reflected accrued revenues?

A. I clearly do.

Q. And, did you submit a response that indicated that the January revenue was more in the nature of $9 million, and the February revenue was more in the nature of $5 million?

A. Yes. I've lost track if that was the formal response or it was a preliminary response, but that's correct. That I used another source of at least approximating what the more reasonable distribution of revenues would be for those two months, calendar month revenues. As we all know, the calendar month is a calculated number, and came up with, subject to check, I'll agree with you with those numbers, yes.

Q. So, you're saying the 9 million and the 5 million are more reasonable estimates of January and February calendar month revenues? Am I understanding you correctly?

A. Yes. Instead of taking it subject to check, I think I have it at my fingertips, so let me just look.

Q. I've actually got copies of it here, if you'd like to look at the response?

A. That's fine.

CHAIRMAN GETZ: Ms. Ross, did you want to mark for identification the --

MS. ROSS: Yes, please. Thank you.

CHAIRMAN GETZ: Okay. We'll mark for identification as "Exhibit Number 6" the one-page chart of the -- entitled the "Working Capital Revenue Lag" from docket DG 06-129.

(The document, as described, was herewith marked as Exhibit 6 for identification.)

THE WITNESS: I want to let the record show that, in attempting to just make our technical session more protective, the Company submitted these draft responses, subject to review and change, to many of the discovery questions that weren't due for at least several days after this. So, what I'm looking at here is a draft response -- "draft responses" it says, and, in particular, a draft to the question that Mr. McCluskey is referring to.

CHAIRMAN GETZ: And, we'll mark these draft responses for identification as "Exhibit Number 7".

(The document, as described, was herewith marked as Exhibit 7 for identification.)

BY MR. McCLUSKEY

Q. So, just so I've got this clear, all the January and February revenues in this response to Staff 1-21 are reasonable or unreasonable estimates of accrued revenues?

A. Yes. I would say that the $6.9 million in January and the 6.02 million in February is a more reasonable spread of calendar month revenues -- calendar month, I'm sorry, calendar month volumes.

Q. And, the revenues -- And, the associated revenues --

A. And the revenues --

Q. -- are reasonable as well?

A. Oh. And, the revenues, I'm sorry, 9 million in January and 5.16 in February are more reasonable.

Q. Okay. If the revenues that you gave us in this response are reasonable, then what value should we attach to the results of your calendar month calculation shown on Schedule JAF-1 and any conclusions that you draw in your testimony relating to a comparison of calendar month and billing month revenues?

A. Yes. As I said, these are calculated numbers, but I would not have a problem dropping in those volumes and those revenues and see what the results of this -- how the results change in this schedule at all.

MR. McCLUSKEY: Okay. Thanks very much.

BY MS. ROSS

Q. I'm going to show you copies of testimony in a Bay State Gas proceeding. And, I show you this because I'd like you to take a look at Exhibit 5, which is a portion --

MS. GEIGER: Excuse me, Ms. Ross. Do you have a copy for us? What is this?

(Atty. Ross handing document to the parties, the Commission, and the witness.)

BY MS. ROSS

Q. Which is a portion of an SEC filing. And, it's discussing the Money Pool, the NiSource Money Pool. And, if you would turn please to Page 11 of that, Exhibit 5. And, if you would read the paragraph that begins "Proceeds of any short-term borrowings from the Money Pool", it's down towards the bottom, next to the last paragraph.

A. "Proceeds of any short-term borrowings from the Money Pool may be used by an Eligible Borrower for the interim" -- "(i)", I'm sorry, "(i) for the interim financing of its construction and capital expenditure programs; (ii) for its working capital needs; (iii) for the repayment, redemption or refinancing of its debt and preferred stock; (iv) to meet unexpected contingencies, payment and timing differences, and cash requirements; and (v) to otherwise finance its own business and for other lawful general corporate purposes."

Q. Now, I believe earlier you stated something to the effect that "the financing community would not be aware that Northern financed these items through a short-term borrowing with the Money Pool"?

A. No, I didn't say "they wouldn't be aware of it". I said that the financing community or lenders, in looking at overall long-term, permanent cost positions, would expect not to get a short-term borrowing rate. This paragraph suggests that, when possible, this Money Pool, if possible, will be available to deal with some payment and timing differences that you underlined here, but that could be for anything, and not necessarily specifically to a permanent gas cost position. It does, it does suggest, and this was my point earlier, that the Money Pool certainly could be used to fund the interest on monthly under-/overrecoveries, i.e. the short-term borrowing rate. But the New Hampshire Commission has always held the position that you use the prime rate for monthly under-/overrecoveries, the balance of those. And, so, we use the prime rate. It's somewhat -- somewhat indifferent in that you have underrecoveries and you have overrecoveries.

Q. It also specifically allows for working cash capital recovery, doesn't it?

A. Again, it will be available, if available, for other -- for other purposes. But that doesn't mean you can count on the Money Pool to fund long-term permanent embedded cost positions that the Company is in.

Q. But working capital is described as one of the purposes as a short-term debt borrowing, isn't it, in this document?

A. "May be used" it says, that's correct. "May be used".

Q. And, Northern is an Eligible Borrower under this Money Pool Agreement, isn't it?

A. That is correct.

MS. ROSS: Thank you, Mr. Ferro. I have no further questions.

CHAIRMAN GETZ: Ms. Hollenberg.

MS. ROSS: May I ask that the SEC filing be marked for identification as an exhibit please.

CHAIRMAN GETZ: That will be marked as "Exhibit 8" for identification.

(The document, as described, was herewith marked as Exhibit 8 for identification.)

MS. HOLLENBERG: Thank you. I actually have no questions.

BY CMSR. MORRISON

Q. Mr. Ferro, for an internal exercise, have you gone back in prior years, perhaps, and used Mr. McCluskey's formula to try to restate and see what the impact would be?

A. Is the question "could I do that?"

Q. Have you done it?
A. Oh. I have not, other than going back to November '05 using actuals. And, the funny thing about that, I shouldn't say "funny", the strange thing about that is that it depends on how one analyzes to try to see what the impact is. I tried to do the best I could, with respect to my attachments, to suggest that there's about a $45,000 difference that would go against the Company if we switched to Mr. McCluskey's method. But, if Mr. McCluskey is thinking that I'm reflecting too little revenues in my billing month calculation or too many revenues, that changes the answer. But that would be my position, yes.
Q. If restated over an entire calendar year, do you think there would be a norming of that deficit to the Company or do you think it would get worse?
A. I think that it would always be the same relative amount against the Company. And, that's primarily because, when you go out of a warm period into a colder period, your volumes drag a little bit more, and the costs are getting -- the volumes are getting higher, the costs are getting higher. Our winter cost of gas is higher than our summer cost of gas. So that, coming out of a warm period into a colder period, puts us in

more of a disadvantage, if, in fact, we try to advance those revenues.

I looked at the volumes, and you could see the volume differences each month. And, at the end of the year, the totals equal they same. But it's just going into that colder period that really disadvantages us.

CMSR. MORRISON: All right. Thank you.

BY CHAIRMAN GETZ

Q. And, Mr. Ferro, I just want to make sure I understand the general substance of your position. And, I guess I'd start by making sure I -- I'll try to restate my understanding of Mr. McCluskey's position, which is essentially between the working capital adjustment and the method of reconciling the cost of gas mechanism, that the Company is recovering twice for the same purpose. That's, I guess, would you agree that that's a fair characterization of his position?

A. Yes. I was almost -- I was getting nervous and have been getting nervous with the expression of "double collecting" or, you know, or "collecting twice". I don't believe Staff believes that, that it's "double collecting". I think Staff is saying that the Company, in some way, is reflecting, to some extent, again, in

its interest on its under-/overrecoveries, as well as in the working capital. And, of course, I disagree.
Q. And, that's why I was trying to get back to what I -- make sure I'm understanding what I think you said in your oral rebuttal. It's really not an issue of over recovery or double recovery, I took you to say, but it's recovery of two different or complimentary types of costs?
A. Absolutely.
Q. But I also, at the same time, understood you to say that, if the volumes were flat for Northern, that you wouldn't have any objection to the -- to the use of the -- or, to the use of the methodology change proposed by Mr. McCluskey, is that correct?
A. That's absolutely correct. And, that's because I still would be recovering --
Q. Yes, but may I just --
A. I'm sorry.
Q. So, then, is what you're saying is, because the volumes are so volatile, that what you're really saying here is there's, for the gas industry, represents some kind of volatility allowance?
A. No, it's a greater mismatch of revenues and costs, and it happens at the times of the year that, at the end of

the year, you're in more of a borrowing position than having use of the customers' money. Now, keep in mind, and you probably do understand this, that, if we went -- if we had a flat load and we didn't -- we were indifferent whether we go to calendar month versus billing month, we still would be calculating carrying costs on the monthly balance. It just would not be impacted by the mismatch of actual billed volumes versus actual purchased volumes, because they would be the same.

CHAIRMAN GETZ: Redirect?

MS. GEIGER: May I have a moment with the witness, Mr. Chairman?

(Atty. Geiger conferring with the Witness.)

MS. GEIGER: May I have just a couple more questions, Mr. Chairman? Thank you.

REBUTTAL REDIRECT EXAMINATION

BY MS. GEIGER

Q. Mr. Ferro, could you please turn to the attachments to your rebuttal testimony. And, could you please speak to the issue that was raised by Ms. Ross with respect to the summer period or the revenues that are reflected for the month of November on that schedule, both beginning -- the beginning column indicates revenues for November, as well as the ending -- the last monthly column labeled "November".

A. Yes. Actually, Mr. McCluskey brought it up. And, certainly, I'm sure he brought it up because he checked the numbers, and the total of "10,124,000" does not include the "1,950,000" in November. I would say that that is a discrepancy that needs to be addressed. And, the way it should be addressed is that this was an analysis starting in November '05. And, starting in November '05, we recorded 30 days of revenues. I would keep the 1,950,000 in the schedule. And, then, end it with a half month in October, because the analysis was November through October, and that analysis was the result of a Commission order suggesting that we had to look back to November '05 to assess this situation.

So, when I go back to November '05, I think it would be -- it would be inappropriate to just start off with a half month of revenues and billing month and suggest that's how much revenues we gave our customers credit for in this calculation. Because, in November '05, we gave 30 days of revenues in the calculation. But I apologize for the fact that the total number is not correct on this schedule.

Q. Mr. Ferro, I think one other area that you spoke about just briefly was the fact that the Commission has allowed the Company to collect the prime interest rate on its monthly over and underrecoveries, is that correct?
A. I'm sorry, could you ask the question again please.
Q. Sure. I believe you testified that the Commission has allowed the Company to collect the monthly prime interest rate on the balances of over and undercollections each -- reflected in each month, is that correct?
A. That is correct.
Q. And, that was recently decided by the Commission last year, is that correct?
A. That is correct.
Q. Okay. And, there's no reason to revisit that decision today, is there?
A. Say again?
Q. There's no reason to revisit that decision today, is there?
A. There is not. But I would say, as I've said already, that the Company is indifferent whether we use the prime rate or the short-term borrowing rate on monthly under-/overrecoveries.

Q. One last area. I believe you were shown an excerpt from the Company's lead/lag study. Do you recall that?
A. I do.
Q. Did you prepare that?
A. I did not.
Q. Who prepared that?
A. Mr. John Skirtich, a consultant to the Company, who is a lead/lag expert.
Q. And, Mr. Skirtich is not available today, is he?
A. He's not.

MS. GEIGER: Thank you. Nothing further.

CHAIRMAN GETZ: Is there anything further for this witness?

(No verbal response)

CHAIRMAN GETZ: Okay. Hearing nothing, then you're excused. Thank you, Mr. Ferro.

THE WITNESS: Thank you.

CHAIRMAN GETZ: Is there any objection to striking the identifications?

MS. ROSS: I would like to ask Mr. McCluskey to take the stand briefly to comment on a couple of areas of testimony from Mr. Ferro.

CHAIRMAN GETZ: Is there any objection

to surrebuttal?

MS. GEIGER: No.

MS. ROSS: This will be quick.

CHAIRMAN GETZ: I don't remember what comes after surrebuttal, but are you going to be seeking whatever that is, Ms. Geiger?

MS. GEIGER: I'll reserve the right, Mr. Chairman, if the need arises. I think it's "double secret probation".

(Whereupon George R. McCluskey was recalled to the stand, having been previously sworn.)

GEORGE R. McCLUSKEY, PREVIOUSLY SWORN

SURREBUTTAL DIRECT EXAMINATION

BY MS. ROSS

Q. Good afternoon again, Mr. McCluskey. Just recently Mr. Ferro was commenting on the schedule which is found attached JAF Attachment 1, Page 2 of 4. And, I would like you to, if you would please, just comment on the line that deals with the "Reported Collections" for the period November through November.

A. Okay. Mr. Ferro indicated that the total revenues does not include the $1.95 million. So, effectively, what we have here is a comparison of accrued revenues with

$10.124 million and billing revenues with approximately $2 million more. So, clearly, you can't attach any value to the results that we've got from this. And, the difference is significant, because essentially what's happening here is you are carrying a $2 million revenue for 12 or 13 months. And, so, the interest on that, if you just calculate the interest up to the end of April, you're talking about $60,000. But, if you carry it for another six months, this could be significant. So, it could totally change the conclusions that you had, as shown on this schedule, with this one error.

Q. And, would you mind commenting on the statement that there's "no net lag days reflected in the over and under reconciliation"?

A. Yes. I disagree with that totally. Recall, when I testified earlier, that I said the cost of gas rate is adjusted in two ways, one of which is for working capital. So, the actual rate itself that gets approved has a working capital component in it. So, when you do a -- when you look back in time and you do a comparison of costs and revenues, you are comparing costs from that period with revenues from that period, based on rates that were approved by the Commission. And, hence, the revenues, the historic revenues must have a working capital component in it, and, hence, it must reflect the net lag of 6.33 days. So, I disagree totally that the over and undercollections do not reflect net lag days.

MS. ROSS: Thank you. I don't have any further questions, Mr. McCluskey. Thank you very much.

THE WITNESS: Thank you.

CHAIRMAN GETZ: Ms. Hollenberg?

MS. HOLLENBERG: I have no questions. Thank you.

MS. GEIGER: Mr. Chairman, in the interest of trying to expedite things, I'm going to ask Mr. Ferro if he could ask a question again about the schedule that we've been talking about.

CHAIRMAN GETZ: Mr. Ferro.

MR. FERRO: Thank you.

SURREBUTTAL CROSS-EXAMINATION

BY MR. FERRO

Q. Mr. McCluskey, if we could refer to JAF-1, Page 2 of 4, where the schedule shows the "1,950,000" in November. Can you estimate if, in fact, we revised this schedule to drop out November '06, what the -- how the interest would change on this schedule?

A. I could do it. I haven't done it. But I could do that.
Q. Would you agree that it would probably be impacted by that monthly interest amount shown under the month of -- the last month of November of "$8,614"?
A. No. I would not.
MS. ROSS: I'm going to -- I think I'm going to object to this question. And, the reason is, I'm worried that, as we try to manipulate these spreadsheets on the stand, we're not going to be able to get a good analysis. I mean, I think if the Company wants to revise that sheet, we'd certainly keep it open for a late filed exhibit, which I think maybe they can make the corrections they're asking Mr. McCluskey to do. I mean, he hasn't got a calculator, he's sitting up there eyeballing this thing.
CHAIRMAN GETZ: Well, I think it's a fair question to ask in the first instance. If he can do it from the stand, and if the answer is "no", then that's fine.
MS. ROSS: Okay.
CHAIRMAN GETZ: But I think Mr. Ferro is asking, you know, what's the magnitude of the change that would have to be accomplished, and if he would agree that that's it?

MS. ROSS: Okay. That's fine.

CHAIRMAN GETZ: But I understand the answer to be "no", that that's -- the $8,614 really isn't the magnitude. Did you have a follow-up, Mr. Ferro?

MR. FERRO: No, I did not. I just -- The number is in black and white there, and I was just asking Mr. McCluskey, in his opinion, if, in fact, we just captured a clean November through October period of 12 months of revenue and 12 months costs, would he agree that the impact on the total interest amount under "billing month" would -- and "calendar month" would be the monthly interest shown in the month of November '06? And, the number is "$8,614" under "billing month" and a small "$205" under "calendar month". That was the question.

THE WITNESS: And, my answer is "no".

MR. FERRO: Okay.

CHAIRMAN GETZ: And, in the interest of time, would it be fair for me to conclude that, if you were to have another round of testimony, that that would be your position?

MR. FERRO: Yes, it would. And, thank you, Mr. Chairman. I would like the opportunity just to revise this schedule and submit it, if that's possible?

CHAIRMAN GETZ: Let's reserve Exhibit

Number 9 for that refiling.

(Exhibit Number 9 reserved.)

MR. FERRO: Thank you very much.

MS. GEIGER: Thank you.

CHAIRMAN GETZ: Anything further for Mr. McCluskey?

(No verbal response)

CHAIRMAN GETZ: Okay. Then, thank you. Ms. Geiger, anything further?

MS. GEIGER: Yes, Mr. Chairman. You indicated if there are any objection to striking the identifications from the exhibits and entering them into evidence. And, we would raise an objection with respect to Exhibit Number 7. That's information that's in draft form that has not yet been finalized. And, the discovery response -- the discovery question and the response to it are not due until I believe the end of the week. So, we would object to having that come into evidence at this point.

CHAIRMAN GETZ: Is there a response, Ms. Ross?

MS. ROSS: Just a minute please.

(Atty. Ross conferring with Staff.)

MS. ROSS: What we would request, since

the response is supposed to be finalized in the next couple days, would be that that exhibit be replaced with the final numbers, when they're available.

CHAIRMAN GETZ: Okay. I guess I have one concern, as I believe we've already discussed this on the record, and there's some testimony on it. I would allow it in as an exhibit, recognizing that it's certainly -- it's provided as a draft. And, I think it goes more to an issue of how much weight we should accord these draft responses. But we would like to see the final responses when they come in. So, I'm going to allow it as an exhibit. Is there any other objections to any of the other exhibits?

(No verbal response)

CHAIRMAN GETZ: Okay. We'll strike the identifications and enter them as full exhibits. Is there anything else before opportunity for closing arguments?

(No verbal response)

CHAIRMAN GETZ: Hearing nothing, then who would like to start, Ms. Ross or Ms. Hollenberg?

MS. HOLLENBERG: I guess I could go first.

CHAIRMAN GETZ: Please.

MS. HOLLENBERG: The Office of Consumer

Advocate agrees with Commission Staff that currently the Company recovers the same 15 days of revenue lags through working capital and the reconciliation. And, the fact that sales can vary significantly over the year are covered in Exhibit 6 through an averaging. Naturally, at times, the revenue lag is higher, and at other times lower than the average, but it all comes out through the use of the average. Thank you.

CHAIRMAN GETZ: Ms. Ross.

MS. ROSS: Thank you. Staff supports the Northern proposed 2007 cost of gas rates as filed, with one reservation, which I'll discuss in a minute. The Commission Audit Staff reviewed the 2006 Summer Season Reconciliation and found no substantive exceptions. The sales forecast is consistent with prior forecasts and reflects market expectations. The proposed Simplified Market-Based Allocation method of assigning various pipeline supplies, storage and peaking resources, and associated costs to C&I customer classes based on load shapes, seems to match resources more closely with actual load patterns. Residential customers will continue to be allocated gas costs based on the system average cost of gas.

The Company has testified that the SMBA

methodology does not result in any resource cost shifting between Northern's Maine and New Hampshire Divisions. Staff recommends approval of the proposed changes related to the SMBA method. Actual 2007 Summer gas costs and revenues will be reconciled prior to the 2008 Summer COG, and any concerns that may arise will be adjusted in that proceeding.

Now, for the reservation. Staff has concerns related to interest on working capital and possible double collection of interest on prior period imbalances. We would ask that the Commission allow this rate to go into effect, but rule as soon as possible on the interest issues with regard to the interplay between working capital and the reconciliation. And, at the time that that decision is made, we would then incorporate whatever changes were needed into the cost of gas, either in the ongoing cost of gas or, if that's not feasible, in the next cost of gas filing. At any rate, we do ask the Commission to decide as soon as possible with regard to Staff's concern about the interplay between these two mechanisms for recovery, and we believe the Company is being overcompensated for its need to supply cash in order to fund the lag between incurring its costs and collecting revenues from customers. Thank you.

CHAIRMAN GETZ: Let me address one administrative matter. I think we need to reserve an exhibit for the update to the draft responses in Exhibit 7. So, reserve, is it Exhibit 9?

MS. BATEMAN: Ten.

CMSR. MORRISON: Ten.

(Exhibit Number 10 reserved.)

MS. ROSS: One other procedural matter. If the exhibit, when it's refiled, JAF-1, Page 2 of 4, contains any additional problems, Staff would like the opportunity to file any comments on it at the time that it's filed, or shortly after it's filed.

CHAIRMAN GETZ: Certainly, to the extent that there's problems, you may comment.

MS. ROSS: Thank you.

CHAIRMAN GETZ: Ms. Geiger.

MS. GEIGER: Thank you, Mr. Chairman. I think Ms. Ross's last comment seems to indicate procedurally the posture which we find ourselves, which is there is still a lot of work we believe to do to make sure that we provide the Committee -- the Commission with a thorough record, so that it can make an informed decision on Staff's request to change the long-standing cost of gas methodology that this utility and other gas utilities in

New Hampshire have been using.

First of all, we would ask respectfully that the Commission approve the rates that the Company has provided in its revised cost of gas filing. We would also ask that the Commission approve the change from the MBA to the SMBA methodology. However, we would ask that the Commission deny the request that Staff is making to change Northern's long-standing COG methodology. We don't believe that Staff has met its burden of proving to the Commission by a preponderance of the evidence that this methodology should be changed or that it produces unjust on unreasonable rates.

In the alternative, should the Commission decide to not reject Staff's request outright, we would ask that the Commission defer ruling on this issue and open up a separate docket that could be handled quickly, yet thoroughly, to make sure that the Commission has the best evidence available to it to make a decision on what we think is a very significant departure from long-standing practice.

Again, we're holding the record open here. Staff has just indicated that they don't ask the Commission to actually make a decision on this issue by May 1st. I don't think we need to rush. However, I do understand the fact that Staff believes or the opinion that Staff has that this matter needs to be decided. I think, out of fairness, KeySpan is looking at this issue or the Commission is investigating this very issue with respect to KeySpan. That's being done in a separate docket. KeySpan was not required to make its case, if you will, in rebuttal to Staff's request in the context of a cost of gas proceeding, which, as we all know, has a very truncated time frame for consideration of some very significant issues.

So, on behalf of the Company, we would respectfully ask that the Commission defer making a decision on any change to the cost of gas methodology until such time as a separate docket is opened and these matters can be vetted a little bit more thoroughly, yet done in a fairly quick time frame. Thank you.

CHAIRMAN GETZ: Is there anything else this afternoon?

(No verbal response)

CHAIRMAN GETZ: Okay. Hearing nothing, then we'll close the hearing and take the matter under advisement. Thank you.

(Hearing ended at 2:18 p.m.)