BEFORE THE STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

In the matter of:	**)**
Unitil Energy Systems, Inc.	**)**
DE 10-055 Distribution Rate Case	**)**

Direct Prefiled Testimony

of

Kenneth E. Traum
Assistant Consumer Advocate

On behalf of the Office of Consumer Advocate

Dated: **November 5, 2010**

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I. Introduction

Q. Please state your name, business address and position.

A. My name is Kenneth E. Traum. I am the Assistant Consumer Advocate for the Office of the Consumer Advocate (OCA), which is located at 21 South Fruit Street, Suite 18, Concord, New Hampshire 03301.

Q. How long have you worked for the OCA?

A. I have been employed by the OCA for approximately 21 years.

Q. Is a summary of your experience attached to this testimony?

A. Yes. Attachment KET-1 is my résumé.

Q. Have you previously testified before the New Hampshire Public Utilities Commission (Commission)?

A. Yes. I have testified before the Commission on behalf of the OCA on many occasions, in adjudicatory proceedings involving electric, natural gas, water and telecommunications utilities.

Q. What is the purpose of your testimony?

A. I provide the OCA's recommendations related to the proposed permanent distribution rate increase and the proposed step increases proposed by Unitil Energy Systems, Inc. (UES) in its filing on April 15, 2010. In addition, I provide the OCA's recommendations on the issues of rate case expense recovery and temporary rate reconciliation.

Q. Please provide a brief summary of the UES proposals.

A. UES originally proposed a 22.8% permanent distribution revenue increase, amounting to $10,115,710.[1] Included within this proposed increase are expenses associated with the December 2008 Ice Storm, enhanced tree trimming, and the establishment of a Storm Damage Reserve Fund.[2] In discovery, UES agreed to reduce this amount by $408,478, to $9,707,232.[3]

UES also seeks multiple step increases to the proposed permanent rates to recover costs associated with additional plant investment, the 2010 Wind Storm, and enhanced vegetation management and reliability spending. UES originally estimated that these steps would increase its revenues in 2011 by $4,701,690, or 9.58%, and in 2012 by another $1,002,345, or 2.0%.[4] The estimated annual total increases associated with the proposed step increases for 2013 through 2015 is $309,400.[5] UES graphically depicted the timing and original amounts of the various proposed revenue increases in discovery.[6]

In addition, based only upon a marginal cost of service study, UES proposes to reallocate the revenue increases to customer classes and redesign its rates. Under these proposals, the residential class rates will increase an average of 37%, as compared to an overall

[1] *See* Prefiled testimony of Mark H. Collin, Exhibit MMC- 1 (Collin Direct), at p. 7 of 53, lines 6-7. On November 3, 2010, UES filed supplemental testimony and revised revenue requirement schedules. Due to the timing of UES's filing, I do not address the revised filing in my testimony.
[2] *See* UES Schedule RevReq-3 (Bates p. 75).
[3] *See* UES's Response to Technical Session Request 14 and Attachment 1 (Attachment KET-2).
[4] *See* UES's Response to OCA 3-20 and Attachment 1 (Attachment KET-3).
[5] *Id*.
[6] *Id*.

average increase of 22.8%. UES proposes this higher percentage increase for the residential class by both increasing the fixed customer charge by 49%, from $8.40 to $12.50, and shifting revenues from the variable energy usage charge to the fixed customer charge.[7]

Q. Please summarize the OCA's positions on the issues discussed in your testimony.

A. The OCA recommends an increase to UES's permanent revenue requirement that is less than the increase proposed by UES. Specifically, the OCA recommends that the Commission approve an increase of no more than $5,918,390.

The OCA requests that any approved revenue increase be allocated to UES's customer classes on an equal percentage basis, and that the revenue requirement of each class be allocated on an equal percentage basis between fixed and volumetric charges. The OCA also recommends that the Commission require UES to file an allocated cost of service study in all future rate cases in which UES will propose to modify the allocation of the revenue requirement between customer classes.

With respect to UES's multiple proposed step increases, the OCA recommends that the Commission approve a reduced "Projected Rate Year" step increase. The OCA also recommends that the Commission deny UES's "Projected Large Capital Project" step increase, as well as the series of five annual step increases associated with its proposed new Reliability Enhancement and Vegetation Management Plans.

[7] *See* UES Schedule PMN 3-2 p. 2 of 4 (Bates p. 439).

Lastly, the OCA recommends that the Commission authorize UES to recover only 50% of its prudently-incurred rate case expenses, following investigation by the Commission and the parties. Any allowable rate case expenses, as well as the difference between the new permanent rates and the temporary rates, should be recovered on a per kWh basis from all customers.

Q. Before turning to each of UES's specific proposals, is there anything more you would like to say about the OCA's positions in this proceeding?

A. Yes. At this time, the OCA does not take positions on some of the issues raised by UES's filing including cost of capital, depreciation, employee benefits and engineering issues. Rather, the OCA reserves its rights to take positions on these issues at the hearing, through cross examination and argument.

Also, the OCA does not take any positions at this time on UES's proposed step adjustment for Distributed Energy Resources Investment in Exeter[8] or UES's supplemental testimony and revised revenue requirement schedules filed on November 3, 2010.[9] With regard to these new filings (and any subsequent filings by UES); the OCA reserves its rights to conduct discovery and file supplemental testimony.

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[8] *See* un-docketed Letter to Debra A. Howland dated October 29, 2010 from Gary Epler (enclosing UES's tariffs proposed to be applied on service rendered on and after January 1, 2011).

[9] *See* UES Amendment to Petition, Supplemental Testimony of Mark H. Collin and related schedules dated November 3, 2010.

II. Permanent Revenue Requirement

Q. Mr. Traum, did you calculate a recommended revenue requirement for UES that takes into account all of the OCA's recommended adjustments, as well as the OCA's rate base recommendation?

A. Yes.

Q. In calculating the OCA's recommended revenue requirement, what rate of return did you use?

A. As a proxy, I used an overall rate of return (ROR) of 8.08%. I calculated this proxy ROR by making one change to UES's requested ROR of 8.83%.[10] Specifically, I replaced UES's proposed return on equity (ROE) of 10.70% with a proxy ROE of 9.00%. This proxy ROE is consistent with the ROE recommendation filed by a Staff expert witness at the Commission in the pending National Grid New Hampshire gas distribution rate case.[11] The ROE and ROR that I used to calculate the OCA's recommended revenue requirement for UES are only proxies; the OCA does not offer an opinion on ROE or ROR at this time.

Q. What is the OCA's recommended permanent distribution rate increase for UES?

A. The OCA recommends a rate increase of no more than $5,918,390 to UES's last permanent revenue requirement set in DE 05-178. By comparison, the temporary

[10] *See* Schedule RevReq-6 (Bates p. 106).
[11] *See* Pre-filed Direct Testimony of Dr. John W. Wilson on behalf of Commission Staff dated October 22, 2010 in DG 10-017, EnergyNorth Natural Gas d/b/a National Grid NH, at p. 39, line 12 (recommended 9.0% ROE allowance) (Attachment KET-4).

revenue requirement approved in this docket was $5.2 million, and the Company's original permanent revenue requirement was $10,115,716.

Table 1 below provides the OCA's Computation of Revenue Deficiency. To develop this amount, I multiplied the OCA's proposed rate base of $129,515,551 by the OCA's proxy rate of return of 8.08%, which resulted in an Annual Income Requirement of $10,464,857. Then, I subtracted the OCA's Adjusted Net Operating Income (NOI) (see Table 2), and grossed up for taxes. The result is a revenue deficiency of $5,918,390.

Table 1 **– OCA Computation of Revenue Deficiency**

OCA Computation of Revenue Deficiency	
Rate Base	$129,515,551
Rate of Return (proxy)	8.08%
Income Required	$10,464,857
Adjusted Net Operating Income (NOI)	$6,945,148
Deficiency	$3,519,709
Tax Effect	1.6815
Total Revenue Deficiency	**$5,918,390**

A. Rate Base

Q. Please summarize UES's rate base proposal

A. UES calculated rate base of $130,364,100 using test-year-end, or December 31, 2009, plant balances.[12]

Q. What is the OCA's rate base proposal?

A. The OCA calculated UES's rate base to be $129,515,551.

[12] Schedule RevReq-5 (Bates p. 102).

Q. How did you calculate the OCA's rate base amount of $129,515,551?

A. I started with test year, five-quarter average rate base of $128,716,112, and added $875,149 to recognize the annualized cost of non-revenue-producing asset additions added during 2009.[13] Then, I reduced the sum of these amounts, $129,591,261, by $75,710 corresponding to two pro forma adjustments discussed below.

Q. Why did you use test year, five-quarter average rate base as a starting point?

A. Using test year, five-quarter average rate base properly matches test-year customer revenues with the investment, which was in service over that same time period to serve those customers.

Q. Why did you increase test year, five-quarter average rate base by the value of test year, non-revenue-producing assets added during the test year?

A. Adding the value of test-year, non-revenue-producing asset additions to rate base recognizes and mitigates the impact these investments have on earnings, particularly during a period of lower sales growth due to the economy. Under the circumstances of this case, the OCA supports this type of adjustment.

[13] *See* Schedule RevReq-5 at Bates p. 102, column 4, line 16; and UES's Response to OCA 3-4 and Attachment 1, column 7, line 16 (Attachment KET-5).

Q. In the summary of your rate base calculation, you referred to a reduction of $75,710 related to two pro forma adjustments. Please explain the first adjustment.

A. The first pro forma adjustment to rate base, a reduction of $50,858, corresponds to amounts owed by FairPoint Communications, Inc. to UES related to their joint pole ownership. In its audit of UES's 2008 Ice Storm costs, the Commission's Audit Staff observed that approximately $50,858 was owed by FairPoint to UES for pole placements related to the December 2008 Ice Storm.[14] At that time, this amount remained unbilled but Audit Staff expected that it would be "billed as soon as verifications and exchange of information is completed."[15]

In discovery, the OCA inquired about the status of this amount due from FairPoint. In response, UES indicated that the amount was included in its proposed rate base and that FairPoint had not been billed for it.[16] UES also stated that it had filed a claim for this amount in the FairPoint bankruptcy proceedings, and that the bankruptcy claim was still pending.[17]

Given the circumstances, at this time the OCA opposes the inclusion in rate base of the $50,858 related to FairPoint's share of pole placement costs. For this reason, I reduced the adjusted test-year, five-quarter rate base by this amount.

[14] Final Report of Commission Audit Staff, dated May 10, 2010 in DE 10-001 ("Final 2008 Ice Storm Audit Report") (Attachment KET-6), at p. 11.
[15] *Id*.
[16] *See* UES's Response to OCA 1-5 (b) (Attachment KET-7).
[17] *See* UES's Response to OCA 1-5 (c) (Attachment KET-7).

Q. Please explain the OCA's second pro forma adjustment to rate base.

A. The OCA's second pro forma adjustment to rate base, a reduction of $24,852, relates to UES's capitalization of property tax expenses of existing facilities included in fixed plant cost. The Commission's Audit Staff also identified this issue.[18]

In response to the Audit, UES agreed to discontinue this practice and adjust its rate filing accordingly.[19] In response to discovery, UES agreed to reduce rate base by $24,852 to account for the discontinuation of the practice.[20] Therefore, the OCA's second pro forma adjustment to rate base relates to this agreed-to reduction of $24,852.

B. Adjusted Net Operating Income

Q. Please summarize UES's proposed Adjusted Net Operating Income (NOI).

A. UES originally proposed an Adjusted NOI of $5,495,262.[21] In response to the Commission's Audit and discovery, UES agreed to reduce its proposed revenue requirement by $408,478.[22] This reduction in the proposed revenue requirement results in an increase to UES's proposed Adjusted NOI to $5,738,184 (UES revised Adjusted NOI).

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[18] *See* Final Report of Commission Audit Staff dated September 22, 2010 in DE 10-055 ("Rate Case Audit Report") (Attachment KET-8), Audit Issue 12, at p. 55.
[19] *Id*.
[20] *See* UES's Response to Technical Session Request 14, Attachment 1 (k) (Attachment KET-2).
[21] Schedule RevReq-1 (Bates p. 72), line 4.
[22] UES's Response to Technical Session Request 14 and Attachment 1 (Attachment KET-2).

Q. Please summarize the OCA's recommended adjustments to UES's proposed Adjusted NOI.

A. Table 2 below summarizes the calculation of the OCA's recommended Adjusted NOI. I began my calculation with UES's revised Adjusted NOI, $5,738,184.[23] Then I increased this UES amount by the amount of the OCA's recommended expense adjustments, $2,029,534 (pre-tax, or $1,206,965 post-tax), which are discussed in detail below. The result is an OCA Adjusted NOI of $6,945,148.

Table 2 –**OCA Recommended Adjusted NOI**

	Pre-tax Adjustments to Expenses	*Tax Adjusted Impact on NOI**	*NOI*
Original Company NOI in RevReq-1			$5,495,262
Company Revisions in TS-14**	$(408,478)	$242,922	$5,738,184
OCA Proposed Adjustments:			
Amortization – 2010 Adjustments	($32,384)		
Merger amortization	($19,779)		
December 2008 Ice Storm	($265,353)		
Corporate headquarters Lease	($141,091)		
Outside Legal Services	($31,807)		
Community Service	($5,569)		
Incentive Compensation	($69,360)		
Postage	($3,421)		
Tree trimming	($430,771)		
Commission Assessment	($283,906)		
Inflation Adjustment	($95,963)		
Major Storm Reserve Fund	($650,000)		
TOTAL OCA Adjustments	**($2,029,534)**	**$1,206,964**	**$6,945,148**

*A reduction in expenses will increase the Company's taxable net operating income. Tax liability will reduce that increase by $822,570.
***See* Attachment KET-2.

[23] *See* UES's Response to Technical Session Request 14 and Attachment 1 (Attachment KET-2).

1. Amortization

a. 2010 Reduction

Q. Please explain the basis of the OCA's first recommended reduction to amortization expense.

A. During the test year, UES booked amortization expense (not related to pension or post-retirement medical costs) of $866,571. In 2010, UES's amortization expenses (not related to pension or post-retirement medical costs) will amount to $834,187, or $32,384 less.[24] UES's filing, however, did not adjust for this known and measurable reduction in amortization expense.[25]

Q. What is the OCA's recommendation with regard to UES's proposed amortization expense?

A. The OCA recommends that UES's proposed amortization expense be reduced by $32,384.

b. Merger Amortization

Q. Does the OCA recommend any further reduction to amortization expense?

A. Yes. UES seeks to recover $19,779 related to "Merger Cost Amortization."[26] The OCA also opposes the inclusion of this amount in UES's amortization expense and recommends a reduction of $19,779 to this expense.

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[24] UES's Response to Staff 3-100 and Attachment 1 (Attachment KET-9).
[25] *See* Schedule RevReq-2 (Bates p. 74), line 16, column 5.
[26] UES's Response to Technical Session Request 2 (Attachment KET-10).

Q. Why does the OCA recommend that UES's amortization expenses be reduced by $19,779?

A. The basis for the OCA's position includes assurances from UES in recent dockets that it would not recover merger costs from customers. UES gave these assurances in its last rate case as well as in the docket involving Unitil Corporation's merger with Northern Utilities.

Specifically, in UES's last rate case, UES witness Robin A. Tafoya testified, "the amortization of costs associated with the merger of [Concord Electric Company and Exeter & Hampton Electric Company] to form UES is excluded from test year amortization expense."[27] Similarly, in the Northern-Unitil merger docket, DG 08-048, UES assured the Commission that the transaction costs are not recoverable from ratepayers.[28] Therefore, the OCA believes that the inclusion in amortization of merger costs is inconsistent with UES's assurances, that these costs would not be recovered from customers.

Q. What is the OCA's recommendation for these amortized merger costs?

A. The OCA recommends that UES's proposed amortization level be reduced by $19,779.

[27] Re Unitil Energy Systems, Inc., DE 05-178, Exhibit RT-1, p. 24 of 42 (Bates p. 90), lines 11-13 (Attachment KET-11).

[28] *See, e.g.*, Unitil Corporation and Northern Utilities, Inc., Joint Petition for Approval of Stock Acquisition, Order No. 24,906 dated October 10, 2008, at p. 35 ("Under section 2.4 of the settlement agreement, transaction and transition costs are not recoverable from ratepayers.") (Attachment KET-12).

c. December 2008 Ice Storm

Q. Please explain the basis for the OCA's next recommended reduction to UES's proposed amortization expense.

A. UES originally proposed to recover $2,410,011 of deferred costs related to the December 2008 Ice Storm.[29] In response to discovery, UES reduced its total deferred costs as of June 30, 2010 to $2,043,881, 'to reflect the agreed-upon adjustments per the 'December, 2008 Snow and Ice Storm Costs Final Audit Report.''"[30] UES's proposed December 2008 Ice Storm Cost recovery includes the use of a 10-year, sum-of-the-year's-digits amortization methodology, which increases UES's revenue requirement by $553,243. The OCA objects to both the total deferred amount and the amortization methodology proposed by UES.

Q. Please explain the OCA's objection to the UES's proposed June 30, 2010 deferred expense value.

A. UES's June 30, 2010 deferred expense value for the December 2008 Ice Storm has not been audited by the Commission. The Commission Audit Staff audited UES's December 2008 Ice Storm costs as of December 31, 2009, in the amount of $1,941,947.[31] Therefore, the OCA opposes the recovery of the un-audited portion of UES's June 30, 2010 deferred expenses for the December 2008 Ice Storm, or $101,954.

[29] *See* Schedule Rev Req 3-9 (Bates p. 89) (amount of deferred costs as of June 30, 2010).
[30] UES's Response to OCA 3-3 and Attachment 1 (Attachment KET-13).
[31] *See* Final 2008 Ice Storm Audit Report, Audit Issue 4, Attachment 1 (Attachment KET-6) ("Total Deferred Costs").

Q. Did you make any adjustments to the audited portion of UES's proposed December 2008 Ice Storm expenses?

A. Yes. I made two adjustments to the audited amount of $1,941,947. First, I added $40,890 to this amount, to account for an adjustment agreed to by UES in discovery.[32] Second, I reduced the balance by $6,242 related to tree-trimming amounts due from FairPoint.[33] As a result of these two adjustments, the OCA recommends a deferred balance of $1,976,595.

Q. Please summarize the OCA's concerns about UES's proposed 10-year sum-of-the-year's-digits amortization methodology.

A. The OCA opposes the proposed 10-year sum-of-the-year's-digits amortization methodology, as it will allow UES to collect more than its actual expenses in years two through ten. For example, in year two of the amortization of these costs, as proposed by UES, UES will collect $65,680 more than its actual expense – and this variance will only grow in years three through ten.[34] OCA opposes this methodology as it is unfair to customers. In addition, UES has not sustained its burden of proving that this proposed methodology will result in just and reasonable rates.

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[32] *See* UES Response to Technical Session Request 14 and Attachment 1 (Attachment KET-2), adjustment (f); and Final Rate Case Audit Report (Attachment KET-8), at pp. 38-39.
[33] *See* UES's Response to OCA 1-5 (Attachment KET-7), subsection a ("The amount of $6,242 for tree trimming is currently included in the deferred ice storm costs. UES will process a billing to FairPoint and will then write off this billed amount as uncollectible, and remove the amount from the storm deferral total.").
[34] *See* Schedule RevReq 3-9.

Q. What amortization methodology does the OCA recommend instead?

A. The OCA recommends that UES's December 2008 Ice Storm costs be amortized using a 10-year straight line methodology. Although there is an annual decline in costs which accrue to the benefit of UES (*i.e.*, recovery exceeds costs), this benefit is much smaller to UES, about $9,500 in year two. The OCA views the straight line methodology as more fair for customers.

Q. Please quantify the OCA's recommended amortization expense level for the December 2008 Ice Storm.

A. Starting with the OCA's adjusted, audited deferred balance of $1,976,595 and using a 10-year straight line amortization methodology, and an 8.08% proxy rate of return, I calculated the amount of amortization expense as $287,890 (as opposed to UES's $553,243). Therefore, the OCA recommends a $265,353 reduction to UES's proposed revenue requirement for this issue.

d. Corporate Headquarters Lease

Q. Please summarize the basis for the OCA's recommended reduction to UES's proposed lease expenses.

A. UES seeks recovery through rates of its lease payments to an affiliate, Unitil Realty, for UES's corporate headquarters on Liberty Lane in Hampton, New Hampshire. According to UES, the lease includes a 12% return on equity (ROE) to Unitil Realty.[35]

Q. What is the OCA's position on the 12% ROE included in UES's lease payments to its affiliate?

A. The OCA opposes the 12% ROE included in UES's lease payments to Unitil Realty. UES has not sustained its burden of proof that the lease expense associated with this ROE is just and reasonable. The OCA recommends that the Commission reduce UES's lease expense recovery by an amount equal to at least a 3% reduction to the lease ROE. Using a 9% ROE as a proxy here would reduce UES's lease expense by $141,091.

e. Outside Legal Services

Q. Please summarize the OCA's concern about UES' proposed level of expenses for Account #923, Outside Services Employed.

A. UES's proposed revenue requirement includes outside legal fees totaling $53,210, which Commission Audit Staff characterized as "high for the test year."[36] For Account #10-20-08-00-923-00-01, the test year amount was $24,702, but amounts in 2007 and 2008 were

[35] *See* UES's Response to Technical Session Request 16 (Attachment KET-14) ("The 12% return on equity was initially specified in the calculation of the lease between Unitil Realty and Unitil Service and is not changed during the term of the long-term lease.").

[36] Final Rate Case Audit Report (Attachment KET-8), at p. 38 (Recommended Expense Normalization concerning "Account 923, Asset Sale-Legal Settlement").

$2,500 and $500, respectively.[37] For Account #10-20-50-00-923-00-00, the test year amount was $28,508, but the amounts for 2007 and 2008 were $500 and $7,500.[38]. On account of these variations, the Commission Audit Staff recommended that a three-year average normalization be considered for this account.[39]

Q. **What is the OCA's recommendation on this issue?**

A. The OCA agrees with and recommends using a three-year average to calculate the pro forma test year expense for Account 923. Using a multi-year average here normalizes the significant fluctuations seen in this account. The recommended three-year average normalization of this expense results in a reduction to UES's proposed expenses of $31,807.[40]

f. Community Service

Q. Please explain the basis for the OCA's next recommended reduction to UES's proposed expenses.

A. UES included in the calculation of its proposed revenue requirement costs associated with its use of company vehicles and employee hours for community service.[41] The amount of these community service costs is $5,699.[42]

[37] *See Id*.
[38] *See Id*.
[39] *See Id*.
[40] *See* UES's Response to Technical Session Request 17 (Attachment KET-15).
[41] *See* UES's Response to OCA 3-21 (Attachment KET-16).
[42] *See Id*.

Q. What does the OCA recommend for these community services costs?

A. The OCA recommends that UES's proposed expenses be reduced by $5,699. UES's efforts to serve its communities are admirable, but customers should not be forced to sponsor these activities through rates. Charitable contributions like these should be sponsored by UES's shareholders, who have some say in how the money is spent.

g. Incentive Compensation

Q. Please summarize UES's proposal for expenses related to incentive compensation?

A. UES proposes that its new revenue requirement include $421,546 for incentive compensation.[43] "The portion of the total amount of incentive compensation included in the proposed revenue requirement that is related to the Company's return on equity is $69,360."[44]

Q. What is the OCA's recommendation on this proposal?

A. The OCA recommends that UES's proposed expenses be reduced by $69,360, the amount related to the ROE. UES's stockholders directly benefit from the incentive compensation that is tied to solely UES's financial performance or ROE. Thus, UES's stockholders – not the ratepayers – should pay the costs of that incentive compensation.

[43] *See, e.g.*, UES's Response to OCA 3-14 (Attachment KET-17).
[44] *See* Id.

Q. Does the OCA have any other recommendation related to incentive compensation?

A. Yes. In a recent PSNH rate case, the Commission approved a settlement agreement that included a term requiring an annual report on incentive compensation.[45] The OCA supports transparent and consistent reporting on incentive compensation by all utilities, and therefore recommends that the Commission require UES to file the same annual report approved in the PSNH rate case. In light of the fact that UES already files its compensation information for officers and directors in a public format,[46] the OCA expects that UES can comply with this recommendation.

h. Postage

Q. Please summarize the UES's proposal for postage expense.

A. UES proposes to increase its postage expense by $5,579 due to a postal rate increase dated May 11, 2009.[47] With this increase, UES's pro forma postage expenses total $331,863.

Q. What is the OCA's position on the proposed increase in postage expense?

A. The OCA does not oppose the proposed increase so long as it is calculated to also include an adjustment for the known and measurable decrease in customers who receive their bills by mail. In discovery, UES indicated that the percentage of its customers who

[45] Re PSNH Distribution Rate Case, Order No. 25,123 dated June 28, 2010, at pp. 15 and 40 (Attachments KET-18); and Settlement Agreement between PSNH, Commission Staff and the OCA dated April 30, 2010, at p. 14, Section 14.4 (Attachment KET-19).
[46] *See, e.g.*, UES's Puc 1604.01(a) (14) filing dated April 15, 2010.
[47] *See* Schedule RevReq-3-5 (Bates p. 84).

received their bills through the mail decreased from 97% in 2008 and 2009 to 96% in 2010.[48]

Q. What is the OCA's recommendation on postage expense?

A. The OCA recommends that UES's pro forma postage expense be reduced by $3,421 to reflect the 1% reduction in the number of customers who receive their bills through the mail ($331,863/.97*.01=$3,421). With this reduction the OCA's pro forma expense for postage is $328,442.

i. Tree trimming

Q. Please summarize UES's proposal for tree trimming expense.

A. UES proposes to increase its 2009 test-year distribution tree trimming expense of $735,739 by $930,771, for a total of $1,666,510.[49]

Q. What is the OCA's position and recommendation concerning UES's pro forma tree trimming expense?

A. The OCA opposes UES's proposed 127% increase but supports an approach that seeks to balance the need for reliability with the impact that the cost of reliability has on customers. In its filing, UES stated that its reliability is "good" and "has historically been better than the New England average after adjusting for customer density."[50] In response

[48] *See* UES's Response to OCA 2-8 (Attachment KET-20).
[49] *See* Schedule RevReq 3-8 (Bates p. 88).
[50] Pre-filed Direct Testimony of Thomas P. Meissner, Jr. (Meissner Direct), at p. 5 (Bates p. 177), lines 1-6.

to UES's perceived "gradual worsening" in reliability,[51] the OCA supports a gradual increase in reliability spending.

Instead of the $930,771 increase proposed by UES, the OCA recommends that the Commission allow UES to increase its tree-trimming expense by $500,000, a reduction of $430,771. The OCA's recommendation is consistent with the level of tree-trimming expense approved by the Commission for the purpose of temporary rates.[52] The OCA's recommendation is also consistent with UES's strategy "to balance reliability of service with cost, rates, customer satisfaction and other factors."[53]

j. Commission Assessment

Q. Please summarize the basis for the OCA's next recommended reduction to UES's proposed expenses.

A. UES collects 100% of its Commission assessment,[54] or $414,778, through distribution rates.[55] However, UES has not shown that 100% of the assessment is associated with distribution service. UES also has other business sectors that require the Company to appear before the Commission, including energy service and transmission related dockets.

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[51] *Id*. at lines 8-9.
[52] Order No. 25,124 June 29, 2010, at p. 7.
[53] UES's Response to Staff 3-53 (Attachment KET-21).
[54] *See* RSA 363-A.
[55] *See* UES's Response to OCA 2-38 (Attachment KET-22).

Q. What is the OCA's position and recommendation on UES' recovery of the Commission assessment?

A. The OCA recommends that the costs of the Commission assessment be recovered directly from each UES business sector – distribution, energy service, and transmission – proportionately based upon revenues. In discovery, UES quantified the amount of the Commission assessment related to distribution revenue as $130,872.[56] Therefore, the OCA recommends a reduction to UES's proposed Commission assessment expense of $283,906.

Q. Do you have any other comments regarding this recommended adjustment?

A. Yes. UES can seek recovery of the Commission assessment related to energy service and transmission through the fully reconciling energy service and transmission rates. Consequently, the overall impact of the OCA's recommended reduction to Commission assessment expense reduces any risks UES would have of less than full recovery if recovery remained fully through distribution rates. Also, it is more appropriate and fairer to assign costs to each business sector rather than having the distribution sector pay all of these costs.

[56] *See* Id.

k. Inflation Adjustment

Q. Please summarize the basis for the OCA's next recommended reduction to UES's proposed expenses.

A. UES proposes to adjust "residual O&M expenses" for inflation.[57] UES defines as "residual O&M expenses" those expenses other than "(1) purchased power costs, (2) specific adjustments previously described in this testimony and (3) expenses that are not directly impacted by general inflation."[58] In other words, UES's "residual O&M expenses" include expenses for which a known and measurable adjustment has not been proposed, so that the Company would receive additional revenue for costs that are not known at this time.

UES originally calculated the impact of its inflation adjustment as $159,645.[59] In discovery, UES reduced the increase to its proposed revenue requirement associated with the inflation adjustment to $95,963.[60]

Q. What is the OCA's position on UES's proposed inflation adjustment for "residual O&M expenses"?

A. The OCA opposes the proposed inflation adjustment as it allows UES to increase rates without any actual, corresponding increase in expenses. This adjustment for hypothetical cost increases reduces the Company's incentive to prudently manage expenses. An

[57] Collin Direct, p. 29 (Bates p. 31), lines 1-15.
[58] *Id*. at p. 29 (Bates p. 31), lines 6-8.
[59] *Id*. at p. 29 (Bates p. 31), lines 12-14; and Schedule RevReq 3-6 (Bates pp. 85-86).
[60] *See* UES Responses to Technical Session Request 14 (Attachment KET-2); and OCA 2-21 and Attachment 1 (Attachment KET-23).

increase in rates associated with an un-known and un-measurable and speculative expense in simply not just and reasonable.[61]

Q. What is the OCA's recommendation on UES's proposed inflation adjustment?

A. The OCA recommends that the proposed inflation adjustment be denied. The exclusion of the inflation adjustment from UES's proposed revenue requirement results in a reduction of $95,963.

l. Major Storm Reserve Fund

Q. Please explain the basis for the OCA's next recommended reduction to expenses.

A. UES's filing includes a proposal to establish a major storm reserve fund (Storm Reserve).[62] The proposed cost of the Storm Reserve is $650,000.[63]

Q. What is the OCA's position on the proposed Storm Reserve?

A. Due to the circumstances of this case, the OCA opposes the proposed Storm Reserve. As I discuss elsewhere in this testimony, the OCA supports some recovery of costs related to both the December 2008 Ice Storm and the February 2010 Wind Storm, totaling up to $1,148,628. Consequently, the OCA opposes including any additional storm-related funds in the new permanent rates.

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[61] *See, e.g.*, Pre-filed Direct Testimony of Steven E. Mullen in UES's last rate case, DE 05-178, June 9, 2006, at pp. 15-16 (Attachment KET-24).
[62] *See* Collin Direct, pp. 31-33 (Bates pp. 33-35).
[63] *See* Schedule Rev Req-3-10, (Bates p. 90).

III. Step Increases

Q. Please summarize UES's step increase proposals.

A. UES proposes multiple step increases: a "Projected Rate Year" step increase; a "Projected Large Capital Project" step increase in 2012 associated with the Kingston and East Kingston substations; and a series of five annual step increases associated with its proposed new Reliability Enhancement and Vegetation Management Plans.[64]

Q. Please describe UES's "Projected Rate Year" step increase.

A. UES proposes a "Projected Rate Year" step increase of $3,508,000 effective on the date of approval of permanent rates.[65] Through the "Projected Rate Year" step, UES seeks to recover the costs of forecasted plant additions through December 31, 2010, as well as the costs of the 2010 Wind Storm.[66] For recovery of the 2010 Wind Storm costs, UES proposes to use a 10-year "sum of the year's digits" amortization methodology. Schedule MHC-10 depicts the calculation of the Rate Year Step increase.[67]

To determine the actual revenue increase associated with the "Projected Rate Year" step, UES proposes to file a "schedule with actual 2010 additions to rate base, and other supporting documentation necessary to calculate the revenue requirement effect of these additions to rate base" no later than March 15, 2011.[68] If approved the revenue increase

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[64] *See*, *e.g.*, Collin Direct, p. 43 (Bates p. 45), at lines 1-9.
[65] Schedule MHC-10, p. 1 (Bates p. 65); and Collin Direct, p. 44 (Bates p. 46), at lines 18-19.
[66] *See* Collin Direct, p. 43 (Bates p. 45), at lines 14-16; and at p. 44 (Bates p. 46), at lines 5-7.
[67] Collin Direct, p. 44 (Bates p. 46), lines 12-14; and Schedule MHC-10, p. 2 (Bates p. 66).
[68] Collin Direct, p. 45 (Bates p. 47), lines 10-14.

associated with the Rate Year Step increase would not be included in the reconciliation of temporary and permanent rates.[69]

Q. Please describe UES's "Projected Large Capital Project" Step.

A. UES originally proposed a "Projected Large Capital Project" step increase in the amount of $692,945.[70] Through the "Projected Large Capital Project" step, UES originally proposed to recover its investment of $3,800,000 for the Kingston and East Kingston Substation projects.[71]

Upon completion of the Kingston and East Kingston Substation projects, UES proposes to file a report with the Commission to provide detail on the costs of the project and a calculation of the revenue requirement associated with these rate base additions.[72] Although UES originally expected the Kingston and East Kingston Substations "to be completed and in service in 2012,"[73] "the specific timing of the ["Projected Large Capital Project" step increase] will depend on the dates that the projects are [actually] completed and placed in-service and the report [is] filed with the Commission."[74] On October 29, 2010 UES filed an updated discovery response noting that UES was seeking a delay in

[69] *See* Collin Direct, p. 45 (Bates p. 47), at lines 1-3.
[70] Schedule MHC-11 (Bates p. 67).
[71] *See* Collin Direct, p. 45 (Bates p. 47), line 19, through p. 46 (Bates p. 48), line 2.
[72] *See* Collin Direct, p. 46 (Bates p. 48), lines 2-6.
[73] Collin Direct, p. 45 (Bates p. 47), at lines 19-21.
[74] Collin Direct, p. 46 (Bates p. 48), at lines 6-8.

the in-service date until June 1, 2013, and estimated a reduction in the cost of the Kingston project.[75]

Q. Please describe UES's annual step increases to recover the costs of the proposed Reliability Enhancement Plan (REP) and Vegetation Management Plan (VMP).

A. UES is proposing to implement a Reliability Enhancement and Vegetation Management Program, consisting of a Reliability Enhancement Plan (REP) and a Vegetation Management Plan (VMP).[76] To support the new REP and VMP, UES proposes increases to maintenance expense and capital project costs based upon projected costs.[77]

UES proposes that the Commission pre-approve its REP and VMP each year and, after the annual plans are implemented, that the Commission reconcile projected maintenance expenses with actual costs and authorize recovery of capital investment from the prior year.[78] Beginning in 2011 and continuing through 2015, as proposed by UES, any VMP and REP expenses and REP capital investment that the Commission approves would be recovered through an annual step increase.[79] Schedule MHC-12 shows the UES's projected revenue requirement calculations related to the REP and VMP rate plan step increases.

Q. For each year starting with 2011 and continuing through to 2015, what is the cumulative revenue increase associated with all of UES's proposed step increases?

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[75] *See* UES Supplemental Response to Staff 1-31 (Attachment KET-25).
[76] *See* Collin Direct, p. 46 (Bates p. 48), at lines 16-18.
[77] *See* Collin Direct, p. 46 (Bates p. 48), at lines 19-20.
[78] *See* Collin Direct, p. 49 (Bates p. 51), lines 10-15; and p. 50 (Bates p. 52), lines 9-18.
[79] *See* Id.

A Based upon a response to discovery, UES's proposed step increases for 2011 are projected to total $4.7 million, and the step increases for 2012 are projected to total $1 million.[80] For years 2013, 2014 and 2015, additional annual increases of $309,000 are proposed.[81]

Q. What are the OCA's positions on the "Projected Rate Year" step increase?

A. First, the OCA takes no position at this time on the prudence of the 2010 rate base additions or the 2010 Wind Storm costs. The 2010 rate base additions and the 2010 Wind Storm costs should be audited by the Commission and neither has been.

Second, the OCA recommends that the "Projected Rate Year" step only include investment in 2010 related to prudent non-revenue-producing asset additions. This recommendation is consistent with the OCA's rate base recommendation discussed earlier.

Third, the OCA recommends that any prudent and audited costs associated with the 2010 Wind Storm be recovered through a 10-year, traditional, straight-line amortization methodology. This recommendation is consistent with the OCA's recommendation for the recovery of any prudent costs associated with the December 2008 Ice Storm.

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[80] *See* UES Response to OCA 3-20 (Attachment KET-3).
[81] *See Id*.

Q. What is the financial impact of the OCA's positions on the "Projected Rate Year" step increase?

A. The OCA's recommendations, assuming no prudence disallowances, would reduce the "Projected Rate Year" step increase by $1,362,980, to $2,145,820.

Q. What are the OCA's positions on the "Projected Large Capital Project" step increase?

A. First, the OCA takes no position at this time on the merits of the capital additions included within the "Projected Large Capital Project" step increase. The OCA also takes no position at this time on the prudence of the costs associated with these capital additions. If the Commission approves the step increase mechanism, the costs and investment associated with the "Projected Large Capital Project" step should be audited by the Commission.

Second, the OCA recommends that the Commission require the Company to explore all reasonable options for avoiding, delaying and minimizing the proposed costs associated with the Kingston and East Kingston substation projects. Based upon UES's response in discovery, there are other potential options yet to be explored.[82] In addition, based on a more recent discovery response on the timing and cost of the Kingston substation project referred to above, further investigation into alternatives seems appropriate.[83]

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[82] *See* UES Response to OCA 3-18 (Attachment KET-26).
[83] *See* UES Supplemental Response to Staff 1-31 (Attachment KET-25).

Third, if the Commission approves the "Projected Large Capital Project" step increase mechanism, the OCA recommends that any actual step increase be calculated using actual property tax rates and actual depreciation rates.[84]

Q. What are the OCA's positions regarding the Annual Reliability Enhancement and Vegetation Management Program Step increases?

A. The OCA is concerned about the magnitude of the cumulative increases in reliability and vegetation management spending proposed by UES. The following example highlights our concerns.

According to Schedule MHC-12, $735,740 is currently included in rates for vegetation management "Baseline" O&M Expenses.[85] For 2011, the Company seeks to increase this "baseline" amount by $930,770, for a total of $1,666,510.[86] If the Commission approves the proposed annual step increases associated with the VMP and REP, an additional $1,192,890, or a total of $2,859,400, will be collected by the Company through rates in 2011 for vegetation management and reliability.[87] This amounts to an annual increase of over $2.1 million, or 300%, over the amount spent in 2009, for an area where costs have been and continue to be under the total control of UES.

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[84] *See* UES Responses to Staff 3-17 (Attachment KET-27) (actual property tax rate will be used to compute the actual property tax amount to be included in the "Projected Large Capital Project" step increase) and Staff 3-18 (Attachment KET-28) (depreciation rates that will be used for the "Projected Large Capital Project" step increase will be based on the actual depreciation rates in effect applied to the equipment that is actually installed).
[85] *See* MHC-12 (Bates p. 68), line 21.
[86] *Id*. at line 22.
[87] *See Id*. (line 10 plus line 17 plus line 24).

Q. Other than the magnitude of the increase in spending, when compared with prior years, what else causes the OCA concern about the proposed revenue increases for vegetation management and reliability enhancement?

A. In discovery, UES provided data about its annual System Average Interruption Duration Index (SAIDI) minutes for the period 1995 through 2009.[88] "SAIDI is the acronym for System Average Interruption Duration Index, which measures the average number of minutes the typical customer is without electricity."[89] According UES's SAIDI trend line, outage minutes have only slightly increased over this 14 year period. Based upon this data, the OCA is concerned that the proposed increases associated with the reliability and vegetation management are out of proportion with the magnitude of the problem(s) they are aimed to solve or avoid.

Q. Based upon these concerns, what is the OCA's recommendation with regard to the proposed annual step increases for the REP and VMP?

A. The OCA recommends that the Commission deny the proposed annual step increases associated with the REP and VMP. The Company has not sustained its burden of proving that these amounts will result in just and reasonable rates.

[88] *See* UES's Response to Staff 3-27 (SAIDI data excluding PUC Major Storms) (Attachment KET-29).
[89] Meissner Direct, p. 5 (Bates p. 177), fn. 2.

IV. Cost of Service and Rate Design

Q. Please summarize the OCA's concerns about UES's cost of service and rate design proposals.

A. The OCA opposes UES's use of a marginal cost of service study to both develop customer class revenue requirements (*i.e.*, inter-class allocation) and allocating costs within classes (*i.e.*, intra-class allocation). While a marginal cost of service study may be one basis for intra-class allocation, inter-class allocation should be done on the basis of an allocated (or embedded) cost of service study. On this point, the Company's cost of service expert, Paul Normand, agrees with the OCA.

For example, in a 2009 Massachusetts Department of Public Utilities case involving Bay State Gas Company, Mr. Normand testified, "The purpose of an Allocated Cost of Service Study is to assign or allocate each relevant component of Bay State's overall costs of service on an appropriate basis in order to determine the proper cost to serve the Company's respective classes."[90] Also, in June 2010, on behalf of Kansas City Power & Light Company, Mr. Normand testified, "The purpose of an Allocated Cost of Service Study is to directly assign costs based on company records or allocate each relevant and identifiable component of cost on an appropriate basis in order to determine the proper cost to serve the Company's customer classes."[91] Despite the opinion of its expert on the

[90] Testimony of Paul M. Normand dated April 16, 2009, in MA D.P.U. docket 09-030, Bay State Gas Co., at p. 3, lines 13-16 (Attachment KET-30).
[91] UES Response to OCA 3-8, Attachment 1, Testimony of Normand dated June 4, 2010, in MO PUC Case No. ER-2010-0355, at p. 2, lines 12-15 (Attachment KET-31).

appropriate use of an allocated cost of service study for inter-class allocation, however, UES did not file one.

In addition to opposing UES's proposed inter-class allocation of the overall revenue requirement, the OCA opposes UES's proposed intra-class allocation of the customer class revenue requirements. With regard to the residential customer class, UES proposes to increase the residential class' monthly customer charge by 48.8%.

Q. What is the OCA's recommendation regarding inter-class allocation of the overall revenue requirement?

A. Without an allocated cost of service study, the OCA can not recommend any changes to the existing customer class allocations of the revenue requirement. Instead, the OCA recommends that the Commission reject UES's proposal to re-allocate customer class revenue requirements on the basis of its marginal cost of service study. The OCA also recommends that any change to the revenue requirement that results from this rate case be allocated to all customer classes on an equal percentage basis. Lastly, the OCA recommends that the Commission require UES to file an allocated cost of service study in any future rate case in which UES proposes to shift cost recovery between customer classes.

Q. What is the OCA's recommendation with regard to the intra-class allocation of class revenue requirement?

A. The OCA recommends that the Commission reject UES's proposal to change the way class revenue is recovered by shifting more of the revenue recovery from the variable volumetric charges to the fixed customer charge. Instead, for rate continuity purposes and to treat small and large customers equally, the Commission should require UES to allocate the class revenue requirements to fixed and volumetric charges on an equal percentage basis.

Q. Please quantify the impact of an equal percentage allocation of the proposed revenue requirement on the residential class, generally, and the residential customer charge, specifically.

A. For example, if the Company's overall proposed 22.8% increase was approved, we believe it should be applied equally to all rate classes, and to each component of rates within classes. Therefore, the residential class revenue requirement would increase by no more than 22.8%, and the rates within the residential class – both fixed and variable – would also increase by no more than 22.8%. Consequently, instead of increasing from \$8.40 to \$12.50 as UES proposes,[92] the residential customer charge would be increased from \$8.40 to approximately \$10.32.

[92] *See* Schedule PNM 3-2, p. 1 of 4 (Bates p. 438), line 1.

Q. Do you have any other comments about UES's proposed rate design at this time?

A. Yes. The OCA supports the Company's proposal to continue to utilize an inclining block structure for the residential class, so that the variable usage charge increases starting with the 251st kWh used by a customer in a month. We believe that this provides a small but important price signal to customers.

V. Rate Case Expenses and Temporary Rate Reconciliation

Q. What is the OCA's concern about UES's rate case expenses?

A. UES estimated that its rate case expenses would exceed $500,000.[93] UES's shareholders will benefit from an increase in UES's revenue that results from this proceeding.

Q. What is the OCA's preliminary position on the recovery by UES of its rate case expenses?

A. At this time, the OCA does not take a position on the reasonableness or prudence of UES's rate case expenses; UES has yet to file specific detailed information about these expenses, including the actual amount of money spent litigating this rate case. However, the OCA recommends that any prudently-incurred rate case expenses be split equally between customers and UES's stockholders. The OCA also recommends that the rate case expenses allocated to customers be recovered through on a volumetric, per kWh basis.

[93] *See* Collin Direct, p. 52 (Bates p. 54).

Q. What is the OCA's concern about the temporary rate reconciliation?

A. The OCA is concerned about the application to the temporary rate reconciliation of the rate design approved by the Commission for the new permanent rates. Changes to rate design are intended – at least in part – to impact customer consumption decisions. If a change to rate design is applied retroactively (*e.g.*, for the purpose of collecting or refunding the difference between the new permanent rates and the temporary rates), customers have no opportunity to change the consumption for which they are being billed; the consumption and the choices underlying that consumption have occurred already.

Q. What is the OCA's recommendation with regards to the temporary rate reconciliation?

A. The OCA recommends that the reconciliation of the new permanent rates with the temporary rates be accomplished on a per kWh basis. This is consistent with the manner in which the temporary rates were implemented.

VI. Summary and Conclusion

Q. Please summarize the OCA's positions included in your testimony.

A. The OCA opposes UES's proposal to increase its revenue requirement for permanent rates by $10,115,179 and instead believes that the evidence supports an increase of no more than $5,918,390. The OCA recommends that any revenue increase approved by the Commission be recovered from UES's customer classes on an equal percentage basis, and that each class's revenue requirement be allocated on an equal percentage basis between fixed and variable charges.

With respect to the proposed step increases, the OCA recommends that the Commission approve a reduced "Projected Rate Year" step increase that allows UES to recover only its prudent and audited costs. The OCA also recommends that the Commission deny UES's "Projected Large Capital Project" step increase as well as the series of five annual step increases associated with its proposed new Reliability Enhancement and Vegetation Management Plans.

Lastly, the OCA recommends that the Commission authorize UES to recover only 50% of its prudently - incurred rate case expenses, following investigation by the Commission and the parties. These rate case expenses, as well as the difference between the new permanent rates and the temporary rates, should be recovered on a per kWh basis from all customers.

Q. Do you have anything further to add before concluding your testimony?

A. Not at this time. However, I will note that two days before this testimony was due, on November 3, 2010, UES filed an "Amendment to Petition, Supplemental Testimony of Mark H. Collin and related schedules," which I have not reviewed. In addition, I wish to again reserve the OCA's rights to respond to the testimony of other parties and any new information provided by UES after the filing of my testimony.

Q. Does this conclude your testimony?

A. Yes.