Liberty Utilities

STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

Docket No. DE 13-063

Granite State Electric Company d/b/a Liberty Utilities
Distribution Service Rate Case

JOINT DIRECT TESTIMONY

OF

CHRISTIANE G. MASON
DR. MICHAEL R. SCHMIDT

March 29, 2013

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ATTACHMENTS

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I. INTRODUCTION

Q. Please state your names and business addresses.

A. My name is ChristiAne G. Mason. My business address is 11 Northeastern Boulevard, Salem, NH 03079.

My name is Dr. Michael R. Schmidt. My business address is 3322 SW Rolling Court, Topeka, Kansas 66610.

Q. Ms. Mason by whom are you employed and in what capacity?

A. I am Director and Head of Regulatory, Government and Community Affairs for Liberty Energy Utilities (New Hampshire) Corp. ("Liberty Energy NH") which owns the stock of Granite State Electric Company ("Granite State" or the "Company"). Liberty Energy NH provides services to Granite State. My management responsibilities are primarily in the areas of compliance, financial and regulatory services.

Q. Please briefly describe your educational background and professional experience.

A. I earned a Bachelor of Science in Business Administration from Franklin Pierce University and in 2001 received a Master's of Science in Finance-Management Information Systems from Rensselaer Polytechnic Institute. I have over 25 years of professional experience in the utility industry in the areas of finance, administration and regulation. For much of my career the NH Public Utilities Commission ("NHPUC" or

"Commission") employed me in varying capacities, including most recently as Director of Administration and Assistant Executive Director, and prior to that as Assistant Director of Telecommunications. In addition to my experience at the Commission, I was employed by ISO-NE in Holyoke, MA as a Project Manager during their Market Systems deployment with responsibility for departmental level Program Management and executive level Markets Implementation reporting. Prior to that, I was employed by Sierra Telephone Company, in Oakhurst, CA, where I was responsible for regulatory matters before the California Public Utilities Commission ("CPUC") and the Federal Communications Commission ("FCC"), as well as for the deployment of their subsidiary, Sierra Tel Long Distance Company. I joined Liberty Energy NH in October 2011.

Q. Have you previously testified or participated in proceedings before the Commission?

A. Yes. I have testified and participated in a number of dockets before the Commission, including: DRM 87-233 Uniform System of Accounts for Telecommunications Companies, DR 89-010 New England Telephone and Telegraph Company Rate Investigation, DE 90-002 Generic Investigation Into Intralata Toll Competition Access Rates, DE 90-200 New England Telephone and NYNEX Information Resources Company telephone directory publishing agreements, Rate Investigations for DR 90-219 Granite State Telephone, Inc., DR 90-220 Union Telephone Company and DR 90-221 Wilton Telephone Company, as well as in, DT 02-165 Investigation of Verizon New

Hampshire's Treatment of Yellow Page Revenues.

Q. Dr. Schmidt, by whom are you employed and in what capacity?

A. I provide services to Liberty Utilities (Canada) Corp. as a Rates Advisor. In this capacity, I advise the regulated operating companies of Liberty Utilities Co., including Granite State, on pricing matters and participate in their rate cases.

Q. Please briefly describe your educational background and professional experience.

A. My doctorate degree is from the Indiana University’s Kelley Graduate School of Business with a double major in Transportation/Public Utilities and Business Economics/Public Policy with a supporting field in Finance. I also earned a Master’s degree in Business Administration with majors in Public Utility Management and Finance from Indiana University’s Kelley Graduate School of Business. I hold two undergraduate degrees from the University of Minnesota: a BA in Business Administration with an emphasis in finance, accounting, and management; and a BS in Physics/Math with an emphasis in electronics, electrical theory, and mathematics.

Professionally, I am a public utility economist with approximately 35 years of experience in utility ratemaking, cost of service, project analysis, finance, forecasting and capital budgeting in the gas, electric and water industries. Spending the first 15 of those years as a consultant, I have managed numerous energy related consulting projects both domestically and overseas including experience with the financing of public facilities.

In addition, I have had over 20 years of on-point experience in managerial positions with both regulated gas and electric utilities. Prior to joining Liberty Utilities (Canada) Corp., I held an appointed position with the Kansas Corporation Commission as Director of Utilities; I directed a staff of 45 accountants, economists, and engineers in the regulation of electric, gas, telephone, water utilities. I was also responsible for pipeline safety in the state of Kansas. I had five direct reports – Audit, Economics, Utility Operations, Telecommunications, and Pipeline Safety. Further detail on my qualifications is presented in Attachment CGM/MRS-1.

Q. Have you previously testified before any regulatory agencies?

A. Yes. My experience includes testifying in over 60 gas and electric utility pricing cases before various state commissions, the Alberta Energy Board, the Energy Regulatory Board of the Philippines, the Federal Energy Regulatory Commission ("FERC"), the U. S. Court of Claims, the Illinois State Legislature, the Kansas State Legislature and the Superior Court of the state of Washington.

II. PURPOSE OF TESTIMONY

Q. On whose behalf are you sponsoring this testimony?

A. We are sponsoring this testimony on behalf of Granite State.

Q. What is the purpose of your testimony?

A. Our testimony is designed to serve several purposes and is presented in the following broad categories: (i) the Company's overall revenue requirement for permanent rates, (ii) the Company's request for a step-increase, (iii) the Company's request for reconciliation mechanisms, and (iv) the request for various tariff changes.

Q. What level of rate relief is sought by Granite State?

A. The Company is seeking to recover an annual revenue deficiency of approximately $14.1 million based on a rate base of approximately $66.8 million. This proposal represents an 18.04% increase in Total Operating. Schedules RR-1 and RR-2 in Attachment CGM/MRS-2 provide a summary of the different components of Granite State's cost of service and revenue requirements. The increase for a typical residential customer using 500 kWh / month is approximately 18% per month on a total bill basis.

In addition, as discussed later in the testimony the Company is seeking approval for a step increase to recover an annual revenue deficiency of approximately $1.2 million based on additional capital spending of approximately $9.2 million for the period ending December 31, 2013.

Q. Please summarize the proposals you are making in this filing for each broad category identified above.

A. Summaries for each broad category are as follows:

<u>**Company's Overall Revenue Requirement for Permanent Rates**</u>

1. Rate Base Adjustments:
    a. The use of a year-end test year at December 31, 2012 to measure rate base to better align revenues and return on rate base with the period in which rates are going to be in effect;
    b. The inclusion of used and useful capital additions in service as of the date of this filing, and
    c. Plant-Related and Post-Acquisition Accumulated Deferred Income Tax, to satisfy the Company's commitment, and the requirements of Order No. 25,370, to hold customers harmless for the elimination of the historical accumulated deferred income tax liabilities resulting from its election under section 338(h)(10) of the Internal Revenue Service Code.

2. Proforma adjustments for "known and measurable" changes in operating expenses:
    a. Remove Non-recurring test year costs;
    b. Remove Non-recurring Post-Acquisition costs, including services provided by National Grid;
    c. Adjust Payroll, Pension, and Benefits costs to reflect the Company's New

Hampshire-based labor complement;

d. Provide for the cost of vehicle leases;

e. Amortize Pension valuation asset and liability incurred on acquisitions;

f. Adjust the amounts included in base rates for Storm Recovery costs and in the Storm Recovery Adjustment, as described below;

g. Adjust O&M costs not otherwise adjusted for general inflation;

h. Full year Algonquin/Liberty services

i. Amortize Depreciation Reserve deficiency;

j. Additional Depreciation expense;

k. Adjust Property and Liability insurance to current costs;

l. Adjust Property taxes based on average increase over the past three years;

m. Adjust Distribution revenue and Other revenue to reflect normal conditions

n. Adjust Bad Debt expense to reflect the average write-offs over the last five years, and;

o. Provide for Income tax expense at statutory rates.

<u>Company's Request for a Step-Increase</u>

1. Reflect plant additions to rate base through December 31, 2013, and;
2. Remove lease expenses for vehicles replaced by purchased vehicles during 2013.

Reconciliation Mechanisms

1. Storm Recovery costs designed to recover $2.8 million annually, with $1.6 million representing the annual average storm cost to be recovered in base rates, and an additional $1.2 million annually in the Storm Recovery Adjustment ("SRA") Factor until the present deficit balance has been fully recovered. The authority to recover pre-staging costs associated with qualifying storms is described in Mr. Saad and Mr. Demmer's testimony;
2. Property Tax Recovery Mechanism to reconcile property tax expenses to actual expenses incurred;
3. Pension Recovery Mechanism to reconcile pension and other post-employment benefits to actual expenses incurred; and
4. The elimination of the GreenUp Service Program.

Certain Tariff Changes

1. Changes in terms and conditions in the Qualifying Facility section to reflect current market rules and updated power rates;
2. Removal of Load Response Program Provision and Transition Service Cost Provision;
3. Changes in terminology related to the commodity portion/power supply of the customers' bills from Default to Energy Service; and
4. Changes to the following customer charges and fees:

a. Service Connection/Activation Fee,

b. Service Reconnection Fee,

c. Service Reconnection Fee After Hours,

d. Variance of Billing Adjustment Due to Meter Test (+/-); and

e. Collection Field Visit Fee.

III. BACKGROUND

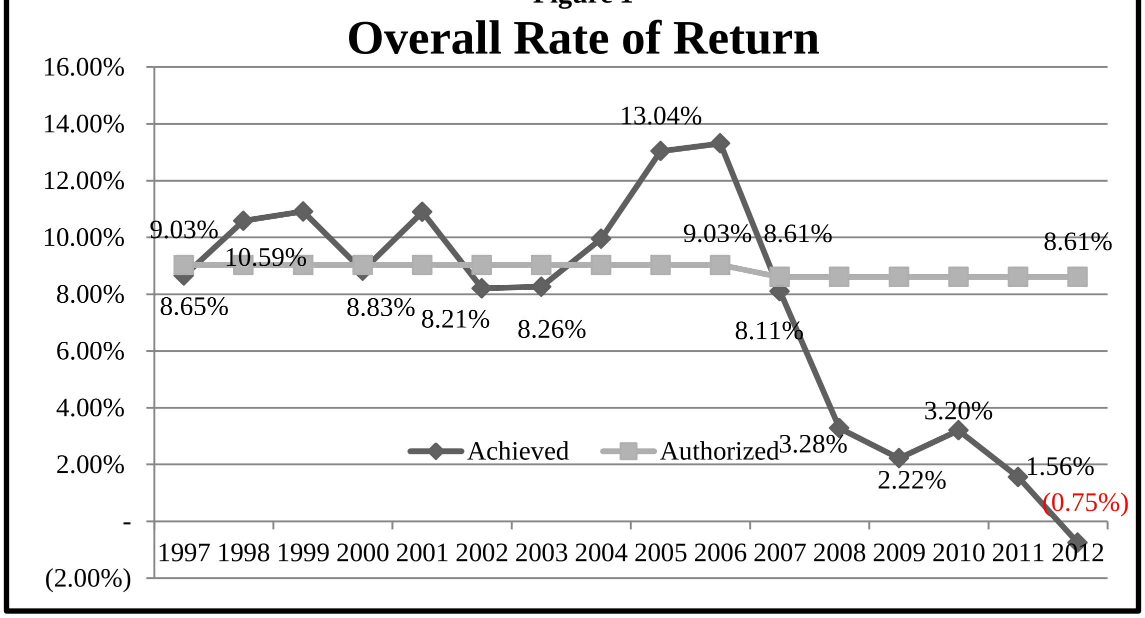
Q. Why is Granite State filing for an increase in its distribution base rates at this time?

A. The increase is necessary because the Company's costs of operation have increased significantly since its last full rate case in Docket No. DR 95-169. The Company's current distribution base rates are not sufficient to allow Granite State the opportunity to recover its distribution related costs including earning a reasonable return. This is demonstrated in the following charts based on information taken directly from the Company's Annual Report on file with the NHPUC.

Figure 1 reflects the Company's achieved overall rate of return compared to its authorized rates of return for the years 1997 through 2012. In DR 95-167, Order No. 22,141 (May 13, 1996), the Company was authorized a rate of return on rate base of 9.03%. As is apparent from this graph, the Company's rate of return has significantly eroded. Currently, the Company's earned return is an unprecedented negative 0.75%, which is approximately 936 basis points below its allowed return of 8.61%. (The

Company's authorized return was reduced to 8.61% in 2007 when National Grid acquired KeySpan and the Company's rates were reduced by $2.2 million in two steps over two years.). *See* Order No. 24,777 (July 12, 2007).

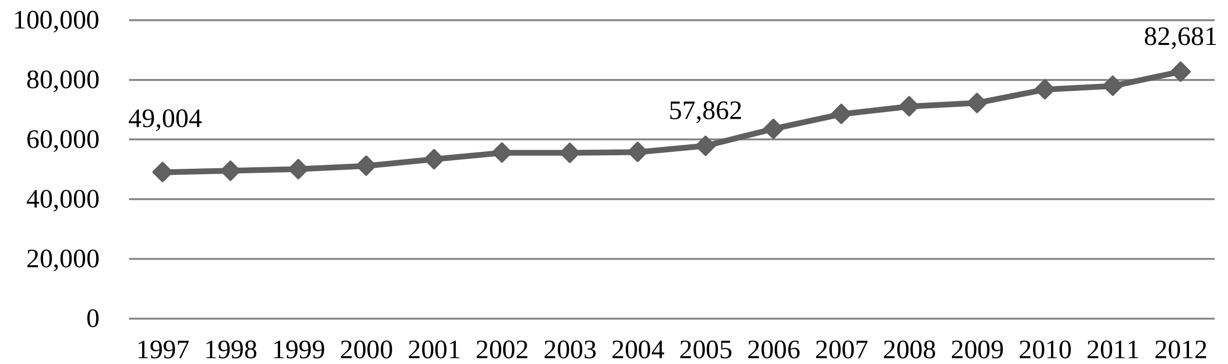
Figure 1



During this same period, the Company has made approximately $94 million in capital additions since the Company's last base rate case. (These additions are described in Mr. Saad and Mr. Demmer's testimony.) Figure 2 demonstrates that net plant in service has grown approximately $33.7 million since 1997. In addition, an aggressive construction program will increase plant further in 2013. Absent the increase in rates requested in this case, the overall return will be driven further into negative territory.

Figure 2

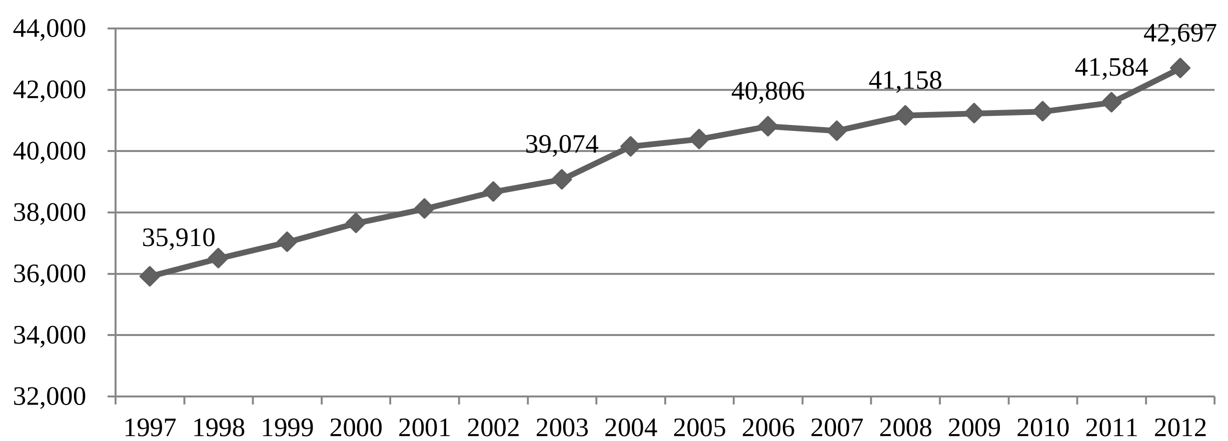
Net Electric Plant



Over that same time Granite State's growth in customers and sales have not kept pace. The number of customers served grew from 1997 to 2006 but has remained relatively flat over the past 5 years as shown in Figure 3.

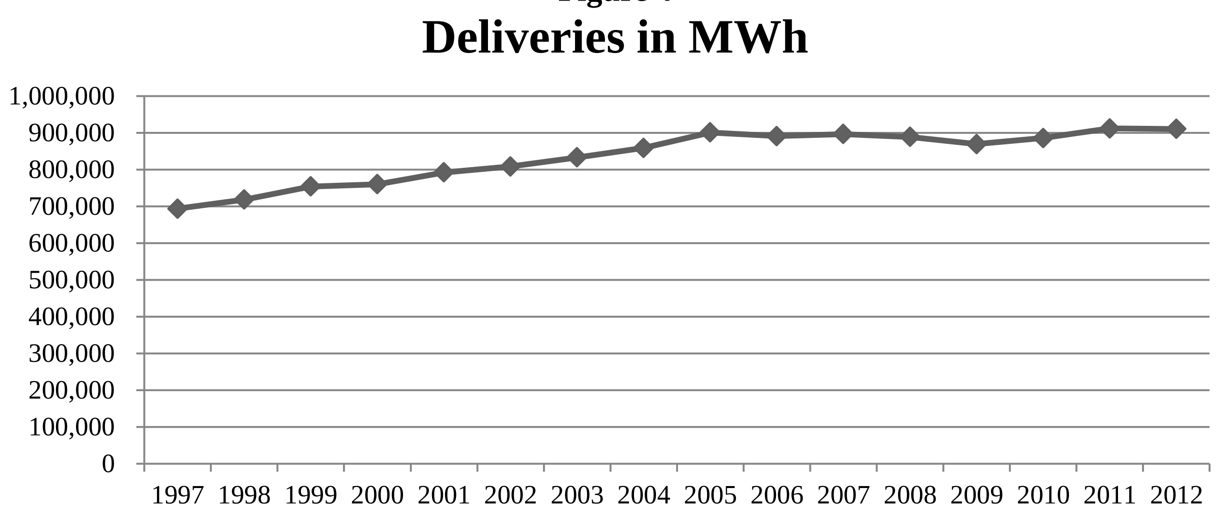
Figure 3

Number of Customers

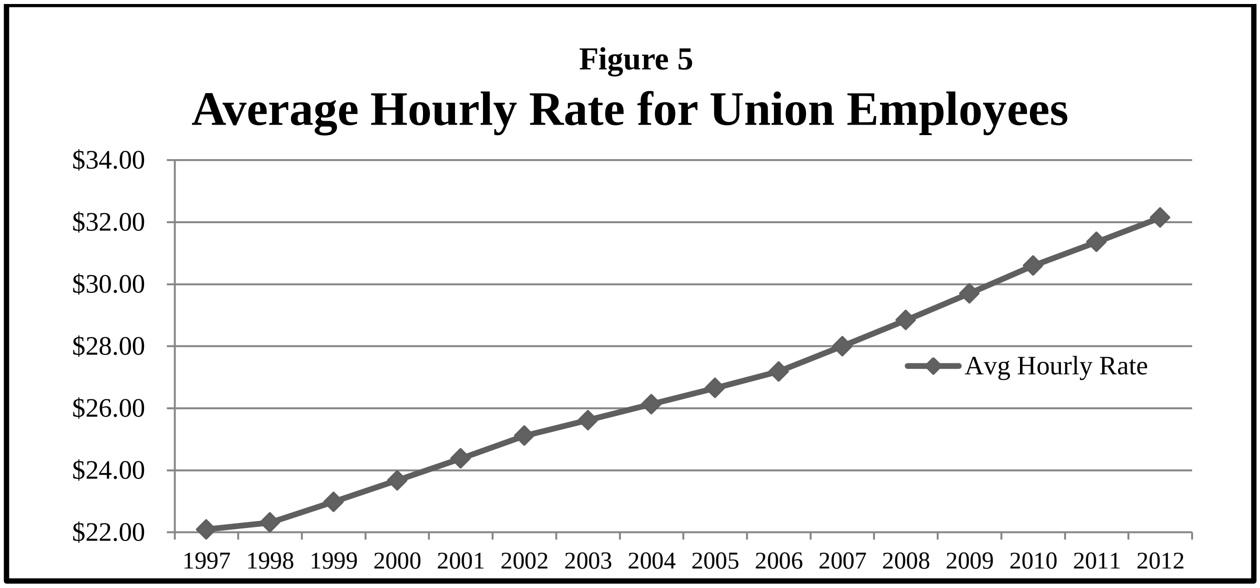


Similarly, Figure 4 demonstrates sales were relatively flat from 2005 to 2012.

Figure 4



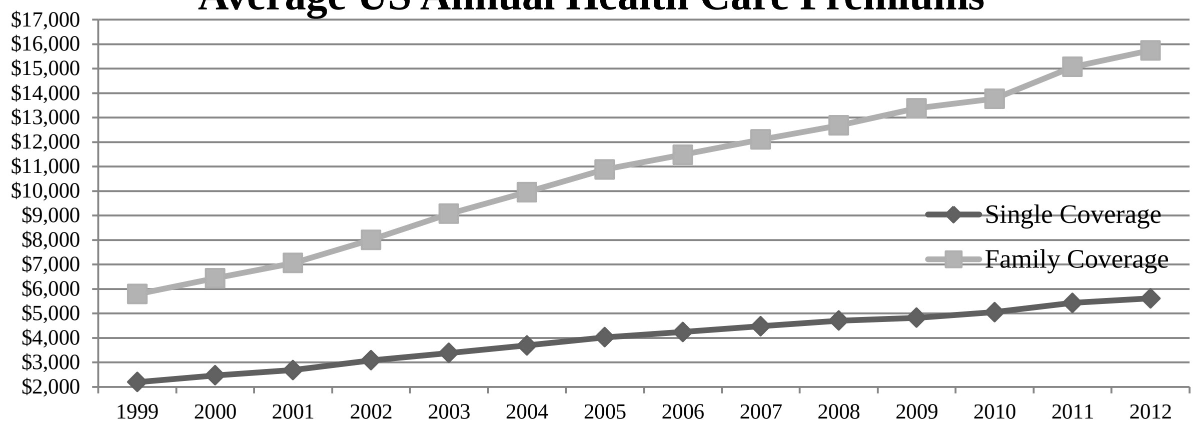
As shown above, the growth in plant investment coupled with minimal customer and sales growth both contribute to the earnings attrition that Granite State is experiencing. In addition, several significant expense categories have increased. For example, the market price for labor has increased dramatically nation-wide since 1997. New Hampshire and Granite State are part of that market and must pay market prices for labor. The increase in the average price of union labor for Granite State shown in Figure 5 represents a 46% increase since 1997.



Along with the rest of the country, Granite State has and continues to experience increases in providing health care insurance to its employees. Figure 6 below demonstrates this trend.

Figure 6

Average US Annual Health Care Premiums



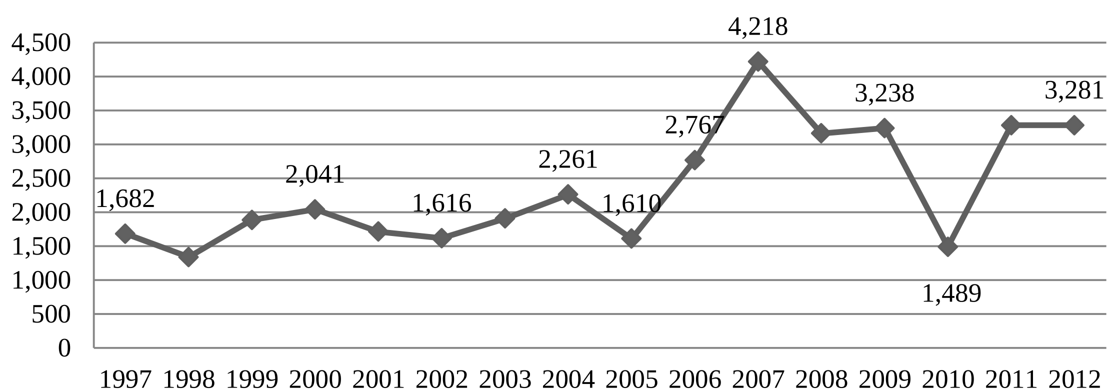
Source: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999-2012

The cost of maintaining the distribution system, primarily due to aging infrastructure and maintenance and storm damage has nearly doubled since 1997. Figure 7 tells the story.

Figure 7

Total Maintenance Expense

($000's)



Property taxes have almost doubled since 2006 rising 91%. Property taxes are discussed later in our testimony and shown in Figure 8.

Overall inflation has also affected the Company's costs of doing business. Based on the Producer Price Index category[1] that is specific to the equipment that the Company typically purchases, there has been a significant increase over the last decade. By this data, there has been a 49.4% increase from 2003; this indicates that a $175,000 line truck purchased today would have cost roughly $117,000 in 2003.

IV. OVERVIEW OF THE DISTRIBUTION RATE CASE

Q. Are you sponsoring any schedules as part of your filing?

A. Yes, we are sponsoring the following schedules in accordance with Puc 1604.07 and 1604.08. The Rate of Return Information required by Puc 1604.08 is provided in Schedule RR-6. The Adjustments to the Test Year required by Puc 1604.09 are provided in Schedule RR-3 with supporting detail in Schedules RR-3-01 through RR-3-20. These Schedules are listed below and found in Attachment CGM/MRS-2.

Computation of Revenue Deficiency and Revenue Requirement	Schedule RR-1
Computation of Gross-up Factor for Revenue Requirement	Schedule RR-1-1
Reconciliation of Proposed Increase	Schedule RR-1-2

[1]United States Department of Labor, Bureau of Labor Statistics, *Producer Price Index Industry Data, Series PCU3339233339237* (2003-2013), http://data.bls.gov/cgi-bin/srgate

Operating Income Statement	Schedule RR-2
Operating Income Statement- Detail	Schedule RR-2-1
Summary of Adjustments	Schedule RR-3
Balance Sheets	Schedule RR-4
Rate Base	Schedule RR-5
Rate Base Quarterly Balances	Schedule RR-5-1
Materials & Supplies	Schedule RR-5-2
Cash Working Capital	Schedule RR-5-3
Rate Base Adjustments-Capital Additions	Schedule RR-5-4
Rate Base Adjustments- Plant-Related ADIT	Schedule RR-5-5
Rate Base Adjustments- Actual ADIT on Historical Assets	Schedule RR-5-6
Rate Base Adjustments- Pro Forma ADIT on Historical Assets	Schedule RR-5-7
Rate Base Adjustments- ADIT on Post-Acquisition Additions	Schedule RR-5-8
Weighted Average Cost of Capital	Schedule RR-6
Weighted Average Cost of Long-Term Debt	Schedule RR-6-1
Historical Capital Structure and Capitalization Ratios	Schedule RR-6-2
Rate Case Expense	Schedule RR-7

Q. Has Granite State filed other material as required by Puc 1604.01?

A. Yes. The material required by Puc 1604.01 is included with this filing in a separate volume.

V. CONDITIONS AGREED TO BY LIBERTY ENERGY NH/GRANITE STATE

Q. In DG 11-040 the Company agreed to not seek recovery of the temporary costs incurred to effect the transaction, committed that no rate impact would result pursuant to an Internal Revenue Code Section 338(h) (10) election, and agreed to evaluate the use of its cost allocation methodology in its next base rate case. Has the Company complied with each of these elements in this filing?

A. Yes.

Q. Please describe the steps undertaken to ensure compliance with those cost recovery conditions.

A. The Company conducted a review to ensure that no transaction costs relating to financing, legal and regulatory costs incurred in connection with the closing of the transaction and no acquisition premium and no transition costs are included in the Company's financial books. Such costs are included in the books and records of the parent company.

Q. Please describe Granite State's ADIT liability commitment referenced in Order No. 25,370.

A. As stated in Order No. 25,370:

> Liberty also commits to holding customers harmless for the elimination of the historical accumulated deferred income tax (ADIT) liabilities resulting from its election under section 338(h) (10) of the Internal Revenue Service Code in accounting for its acquisition of Granite State common stock in this transaction. Further ratepayer protection is achieved by maintaining Proforma accounting for regulatory purposes to continue to provide ratepayers with the ratemaking benefit of Granite State's pre-acquisition ADIT balances until such time as actual ADIT balances related to the historical utility plant assets acquired equals or exceeds the levels that the Proforma ADIT would have been, absent the proposed transaction. The ADIT balances related to capital additions after the closing date are not affected by the section 338(h) (10) election and the treatment of these balances will not change for accounting and ratemaking purposes.

Order No. 25,370 at 31.

Q. Did Granite State take the 338(h) (10) election for tax purposes?

A. Yes, Granite State did take the 338(h) (10) tax election and therefore will honor its commitment to hold customers harmless from this tax election.

Q. How will Granite State hold customers harmless?

A. Granite State will hold customers harmless by maintaining proforma accounting that provides customers with the ratemaking benefit of the Company's historical ADIT balance until the new post-acquisition ADIT equals or exceeds the historical proforma amount existing at the time of the acquisition.

Q. How did the Company compute proforma ADIT for ratemaking purposes?

A. Granite State modeled its approach after a nearly identical issue outlined in the Northern

Utilities, Inc. ("Northern") acquisition application, Docket No. DG 11-069. In that docket, Northern also agreed to hold customers harmless for the elimination of ADIT resulting from taking the 338(h) (10) election. Northern calculated its ADIT as if the 338(h) (10) election had not been made in order to provide its customers the value of the ADIT reduction to rate base. Granite State used the same approach in calculating its ADIT liability. The calculation of the ADIT liability is shown on Schedule RR-5-5. The result of Granite State's calculation was an ADIT balance related to acquisition assets of $21,650,557 as of July 2, 2012, and $45,279 for ADIT related to post-acquisition capital additions from July 3 through December 31, 2012. Thus, the adjustment to rate base is $21,695,836, which represents the ADIT balance computed as required by Order No. 25,370.

<u>Capital Additions through March 31, 2013</u>

Q. Why did you include in the rate base capital additions through March 31, 2013?

A. As described in Mr. Saad and Mr. Demmer's testimony, some projects required a substantial outlay of capital and were in service, used, and useful by the date of filing this case.

Cost Allocation Methodology

Q. Is the Company presenting its cost allocation methodology as part of this rate case?

A. Yes. As required in the Settlement Agreement in Docket No. DG 11-040, the Company met with Staff and the Office of Consumer Advocate on December 12, 2012 to present its cost allocation methodology. The Company is including that cost allocation methodology in this filing as Attachment CGM/MRS-3.

Q. Were costs included for other affiliates of Liberty Energy NH?

A. Yes. Costs related to services provided by parent companies were either directly charged or allocated to Granite State.

Q. How were these costs calculated for this rate case?

A. The costs were developed by using six months of actual charges, adjusted for one-time and non-recurring charges to Granite State. These costs were then annualized based on expected annual activity adjusted for an average non-recurring cost percentage based on the six months of experience. These adjustments are reflected in Schedule RR-3-13.

Q. Can you provide an overview of Liberty's business model?

A. Yes. Algonquin Power & Utilities Corp. ("APUC") serves as the overall corporate umbrella and has two major operating subsidiaries, Algonquin Power Co. ("APCo") and Liberty Utilities Co. ("Liberty"). APCo is the unregulated entity that provides renewable power generation from facilities owned throughout Canada and the United States. Liberty is the entity that owns regulated water, wastewater, gas and electric utilities in the United States.

Q. What is the importance of these entities in relation to Granite State?

A. APUC serves a significant and very important role in relation to Granite State and its sister companies including:

1. Access to skilled strategic management. This means Granite State enjoys access to expertise and resources that are typically not available to small utilities with 43,000 customers.
2. Controls and Processes. Controls and processes are in place to ensure that accounting methodologies are consistent with generally accepted accounting principles.
3. Economies of Scale. By sharing regional resources with other utilities, Granite State enjoys the benefits of lower overall cost structures while at the same time maintaining a local flavor in its day-to-day operations and customer contact. Further, as Liberty's portfolio grows, its overall costs will increase proportionally less than they would if Granite State were operating without this support.
4. APUC, as the entity that is traded on the Toronto Stock Exchange, ensures that Granite State has uninterrupted access to capital.

Q. What types of costs are incurred and allocated to Granite State?

A. Costs from APUC include corporate management and executive labor, which are allocated to each operating subsidiary, i.e., Liberty and APCo. These costs also include corporate treasury, audit services, tax services, third party professional services, and services related to shareholder administration such as Board of Directors and Escrow payments. Related administration charges, such as rent and depreciation and office space, are also charged to Granite State from APUC.

Liberty provides strategic oversight, procedures, compliance, and standards to the utilities it owns in the areas of Finance, Regulatory Affairs, Human Resources, Customer Service, Information Technology, and associated administrative functions. As such, Liberty allocates labor costs and other administrative charges incurred in order to provide these services to its utilities.

Q. Is there a cost allocation manual that governs this process?

A. Yes. The methodologies and processes are set forth in APUC's Cost Allocation Manual ("CAM") which is included as Attachment CGM/MRS-3. The CAM generally describes the types of costs, the methodologies used to allocate them, and the benefits of such costs. In general, the CAM is built around the National Association of Regulatory Utility Commissions ("NARUC") guidelines for cost allocations. The fundamental premise of those guidelines is to directly charge costs based on incurrence as much as possible and use reasonable allocators where allocation is necessary.

Q. Can you cite specifically the principles from the NARUC guidelines you are referring to?

A. Yes. The NARUC guidelines specifically state their principles as:

1. To the maximum extent practicable, in consideration of administrative costs, costs should be collected and classified on a direct basis for each asset, service or product provided.
2. The general method for charging indirect costs should be on a fully allocated cost basis. Under appropriate circumstances, regulatory authorities may consider incremental cost, prevailing market pricing or other methods for allocating costs and pricing transactions among affiliates.
3. To the extent possible, all direct and allocated costs between regulated and non-regulated services and products should be traceable on the books of the applicable regulated utility to the applicable Uniform System of Accounts. Documentation should be made available to the appropriate regulatory authority upon request regarding transactions between the regulated utility and its affiliates.
4. The allocation methods should apply to the regulated entity's affiliates in order to prevent subsidization from, and ensure equitable cost sharing among the regulated entity and its affiliates, and vice versa.

5. All costs should be classified to services or products, which, by their very nature, are regulated, non-regulated, or common to both.
6. The primary cost driver of common costs, or a relevant proxy in the absence of a primary cost driver, should be identified and used to allocate the cost between regulated and non-regulated services or products.
7. The indirect costs of each business unit, including the allocated costs of shared services, should be spread to the services or products to which they relate using relevant cost allocators. [2]

APUC's CAM follows these principles and, as a result, provides for the appropriate allocation of the prudently incurred corporate costs to Granite State.

VI. DEVELOPMENT OF THE DISTRIBUTION REVENUE REQUIREMENT

Q. Please summarize the information you have provided to calculate the Rate Base.

A. Schedule RR-5 shows the calculation of Rate Base. After adjustments, the Proforma Rate Base for the test year is equal to $66,775,043. Schedule RR-5-1 includes several rate base calculation methodologies, including the "Test Year 2-point Average" (arithmetic average of the beginning and end of test period amounts), the "5 Quarter Average", and the "End of Test Year" at December 31, 2012.

[2] National Association of Regulatory Utility Commissioners, *Guidelines for Cost Allocations and Affiliate Transactions,* http://www.naruc.org/Publications/Guidelines%20for%20Cost%20Allocations%20and%20Affiliate%20Transactions.pdf (2007)

Q. Please describe Schedule RR-5-2.

A. Schedule RR-5-2 presents details on the Materials and Supplies inventory calculated as a 5-quarter average as required by the Commission per 1604.07(p)(2).

Q. Please describe the cash working capital calculation.

A. The cash working capital calculation, detailed on Schedule RR-5-3, results in a $5.1 million cash working capital allowance. The Company utilized the 45-day formula method of computing cash working capital that is based on a revenue lag period of one-half of a utility's billing cycle plus 30 days. Since the Company bills its customers monthly, the lag period under this formula approach is 45 days. This formula approach conforms with Puc 1604.07(t).

Q. Please list the Rate Base Adjustments.

A. In addition to Cash Working Capital, the following Rate Base Adjustments were made as shown on Schedule RR-5:

1. Plant in service was increased by $3,000,000 representing the estimated cost of assets placed in service by the end of the Test Year but not yet classified to plant accounts, and by $830,500 for fleet vehicles that were placed in service after the end of the Test Year but before March 31, 2013. Depreciation expense, accumulated depreciation and ADIT were also adjusted for those items. These computations, will be adjusted once the actual Plant in Service amount is known.

2. Materials, Supplies, and Prepayments are included in Rate Base at their average value during the test year.
3. Construction Work in Progress ("CWIP") was removed from rate base.
4. Accumulated deferred income tax has been included as a reduction to rate base, in accordance with the Commission's Order No. 25,370, as shown in Schedule RR-5-5 and as we previously discussed.
5. Customer deposits are included as a reduction to rate base at their value on December 31, 2012.
6. All deferred debits and credits were removed from Rate Base.

Q. What approach was used to perform the revenue requirement analysis?

A. The revenue requirement analysis was developed using a proforma test year approach. This approach utilizes "per books" data adjusted for known and measurable changes to develop normalized revenues, expenses and net operating income for ratemaking purposes. The adjusted net operating income is compared to the required operating income, based on the overall rate of return applied to the test period rate base, to determine the deficiency. The deficiency is then grossed-up for state and federal income taxes and bad debt expense to determine the total revenue deficiency.

Q. Please summarize the results of Granite State's distribution revenue requirement.

A. Schedule RR-1 shows the computation of the requested distribution revenue increase and distribution revenue requirement. The revenue deficiency is $14,168,940 based on an overall rate of return on a proforma rate base of 8.32 percent and known and measurable adjustments to test year revenues and expenses. Schedules RR-1-1through RR-7 provide the detailed analyses and support for the various amounts summarized on Schedule RR-1, including proforma test year revenues, expenses and rate base.

Q. Please describe the test year operating income as adjusted and used to determine the revenue deficiency.

A. The proformed operating income for Granite State in the test year is presented on Schedule RR-2-1. As shown on the Schedule, the "per books" revenues, operating expenses and net operating income are set forth in "Test Year Ended 12/31/2012"column. In the "Flow Through Items," column, the revenue and expenses related to Commodity Sales and Transmission Service were removed because these costs are not recovered in base distribution rates. After subtracting these items, the results are shown in the column labeled "Distribution Operating Income." The "Normalizing Adjustments" and "Known and Measurable Adjustments" are then applied to arrive at the column labeled "Test Year At Current Rates." Finally, the "Proposed Increase" in distribution revenues, bad debt expense, and income tax expense are applied to yield the values shown in the column "Distribution Operating Income with Proposed Increase."

Q. Please describe the test year operating and expenses as adjusted and used to determine the revenue deficiency.

A. A summary of the proforma adjustments is included in the distribution cost of service shown in Schedule RR-3. Below is a description of each item.

Q. What adjustment was made to payroll expense?

A. The reduction in Granite State's reliance on TSAs necessitates a proforma adjustment to payroll expenses. The payroll expense adjustment as detailed on Schedule RR-3-1 adjusts the test year payroll charged to O&M Expense for known and measurable changes. The adjustment reflects payroll increases for employees due to salary and wage increases and the hiring of additional employees referenced in Attachment MES-2 to Mr. Smith's testimony. These newly hired employees will replace services provided by National Grid through the TSAs. Accordingly, Granite State has been hiring and training employees in order to provide these services and plans to have a full complement of employees to provide all necessary services, excluding certain customer services by December 31, 2013.

Q. What is the net effect of removing National Grid costs and TSAs and replacing them with Granite State and Algonquin/Liberty employees and costs?

A. The net effect of removing National Grid costs and replacing them with Granite State and costs is to <u>reduce</u> the revenue requirement by approximately $350,000 as shown in

Attachment CGM/MRS-4. As discussed in our testimony below, the pre-acquisition and post-acquisition labor costs of the services that were provided by National Grid and included in the test year have been removed from the revenue requirement in Schedule RR-3-07 and 3-08. Therefore, we have removed from the revenue requirement the costs included in the test year that will not recur in the future (i.e., the costs of services provided by National Grid), and we have replaced them with the cost of the Company's employees providing those services.

Q. What adjustment was made to payroll taxes?

A. The Payroll Tax adjustment, as detailed on Schedule RR-3-02, increases the test year expense by $181,782 and aligns Payroll Tax expense with Granite State's payroll as developed on Schedule RR-3-01.

Q. What adjustment was made to pension and benefits expense?

A. The pension and benefits adjustment, as detailed on Schedule RR-3-03, updates pension expense and other benefits costs to reflect the latest actuarial report and to align the expense with Granite State's payroll as developed on Schedule RR-3-01. The adjustment, which is shown on Schedule RR-3-03, adjusts test year expenses as follows:

Employee Pensions and Benefits (account 926) Historica	$2,017,840
Costs that have been eliminated	(894,631)
Costs added for new employees	847,260

Amortization of Valuation allowance	2,118,870
Employee Pensions and Benefits (account 926) Adjusted Rate Year	$4,089,338

Consistent with treatment required in prior acquisitions. Absent the acquisition of Granite State by Liberty, the future Pension cost due to valuation as of July 2, 2003 would have been included in Pension expense in the actuarial reports; upon the acquisition, a valuation allowance was established that must be amortized in order to reflect that cost in rates.

Q. What adjustment was made to property and liability insurance?

A. Property and liability insurance expense includes the cost of insurance that provides protection from casualty and other losses and from other damages that the Company may incur in the conduct of its business. This adjustment was made to proform the expense to reflect known and measurable changes in premiums. Property and liability insurance is further adjusted to remove any capitalized amounts. To the extent that any changes in the insurance premiums become known during the course of this proceeding, the Company will update this adjustment. As shown on Schedule RR-3-04, the proforma adjustment is an increase of $81,292 for property and liability insurance to test year O&M expense.

Q. What adjustment was made for leased vehicles?

A. The Company has included the cost of leased vehicles in the revenue requirement. The cost of vehicles that the Company will be purchasing to replace the leased vehicles is in the Step Increase. The Step Increase was reduced by the revenue requirement effect of the leased vehicles. The Leased Vehicle adjustment is shown on Schedule RR-3-05.

Q. What adjustment was made for general inflation?

A. The general inflation adjustment, as detailed on Schedule RR-3-06, represents an increase in costs for items not specifically adjusted on other schedules in computing the revenue requirement. The inflation rate of 1.90% is based on the report *U.S. Macroeconomic Outlook Alternative Scenarios April 2012*, prepared by Moody's Analytics. More recent forecasts from other sources indicate a short-term inflation rate of 2.0%-2.1%.

Q. What adjustment was made for non-recurring costs in test year pre-acquisition and post-acquisition (TSA) costs?

A. The adjustment to remove non-recurring costs in the pre-acquisition portion of the test year is detailed on Schedule RR-3-07, in the amount of $4,402,458, and the adjustment to remove non-recurring costs in the post-acquisition (TSA) portion of the test year is detailed on Schedule RR-3-08 in the amount of $761,183. Consistent with our testimony above, any pre-acquisition and post-acquisition labor costs of the services that are no longer provided by National Grid and were incurred during the test year have been removed. Similarly, we have removed from the revenue requirement the costs included in the test year that will not recur in the future (i.e., the cost of services no longer provided by National Grid), that were replaced with the cost of Liberty Energy NH's employees providing those services. The exception was TSA costs related to certain customer services, as the systems necessary to provide those services will not be complete until 2014.

Q. What adjustment was made for the Major Storm Reserve Fund?

A. A known and measurable adjustment of $609,141 was made to the Test Year amounts to reflect the proposed increase in annual storm funding described later in our testimony. The adjustment is shown on Schedule RR-3-10.

Q. Please discuss the adjustments for Depreciation Annualization and Rates.

A. The adjustment for Depreciation Annualization and Rates is presented on Schedule RR-3-11. This adjustment first annualizes depreciation expense by applying the existing depreciation rates to Plant in Service at December 31, 2012, then the adjustment applies the proposed depreciation rates recommended by Company witness Mr. Watson. The result is depreciation expense computed on the year-end rate base at the proposed rates. This adjustment increases depreciation expense by $300,024.

Q. Please discuss the adjustment for Depreciation Reserve Deficiency Amortization.

A. The adjustment for Depreciation Reserve Deficiency Amortization, detailed in Schedule RR-3-12, increases depreciation reserve deficiency by $316,017. This result reflects the methodology of truing up the actual to the theoretical reserve balances as more fully discussed by Mr. Watson in his testimony.

Q. Please discuss the adjustment for Algonquin/Liberty Services Costs.

A. The adjustment for Algonquin/Liberty Services Costs is detailed on Schedule RR-3-13. The adjustment reflects the allocated cost of services provided to Granite State by its parent company and affiliates that we discussed earlier in our testimony.

Q. Please discuss the adjustment for property taxes.

A. The adjustment for property taxes is detailed on Schedule RR-3-14. This schedule also presents additional information related to property taxes required by the Commission in a full rate case, including taxation period, amount paid, assessed valuations, and tax rates by municipality. The property tax adjustment is $405,612 of which $302,009 is a normalizing adjustment and $103,603 is a pro forma adjustment. The test year property tax for each taxing jurisdiction was increased by the average increase in the tax rate for that jurisdiction over the past three years.

Q. Why is the proforma property tax adjustment estimated?

A. Property taxes are generally billed by municipalities in two installments. The first billed installment for 2012 is generally estimated based on 2011 property taxes, and the second billed installment will reflect the final accounting for 2012. Typically, the second billing installments are received by Granite State in October and November, with payments due in November and December. The State bills its property tax once a year in the fall, while requiring estimated payments on a quarterly basis. Granite State estimated the increase in its property tax expense to be equal to the average property tax expense increases for the period 2010 to 2012, as shown on Schedule RR-3-14. The property tax adjustment will be updated during this proceeding for the final property tax bills.

Q. Please discuss the adjustment for other revenue.

A. The adjustment for other revenue is presented on Schedule RR-3-15. Other revenues comprise forfeited discounts, miscellaneous service revenue, rent from electric property, CTC revenue, border sales, Fairpoint revenue and Other revenue, as shown on the Schedule. Each item included in other revenue was reviewed and the required adjustments are also shown in Schedule RR-3-15. Forfeited discounts, or late payment charges, were increased to reflect the estimated total bill increase requested by the Company; this amount will be adjusted during the course of this proceeding if necessary.

Q. Please describe the adjustment for Income Tax Expense - Test Year Actual and Income Tax Expense - Test Year Adjusted at Current Rates.

A. The adjustments for Income Tax Expense - Test Year Actual, detailed on Schedule RR-3-17, and Income Tax Expense - Test Year Adjusted at Current Rates, detailed on Schedule RR-3-18, reflect an adjustment to income tax expense in the test year in order to provide for income tax at current statutory rates.

The adjustment for Income Tax Expense - Test Year Actual, on Schedule RR-3-17, adjusts income tax expense before ratemaking adjustments to the statutory rates. The adjustment for Income Tax Expense - Test Year Adjusted at Current Rates, on Schedule RR-3-18, provides for the income tax effect of the ratemaking adjustments listed on the schedule.

Q. Please discuss the adjustment for Distribution Revenue at Current Rates.

A. The adjustment for Distribution Revenue at Current Rates is presented on Schedule RR-3-19, and reflects the distribution revenue based on the normalized sales volumes calculated and presented by Mr. Gorman on Attachment Schedule HSG-3.

Q. Please discuss the adjustment for Bad Debt expense.

A. The adjustment for Bad Debt expense is presented on Schedule RR-3-20. The adjustment develops the ratio of Granite State's actual charge-offs to revenue over a five-year period.

The ratio is then applied to test year revenue to adjust the Bad Debt expense at current rates in the test year. The ratio of Bad Debt expense to revenue is also applied on Schedule RR-1-1 to gross-up the proposed revenue increase to collect revenues for unrecovered write-offs.

Weighted Average Cost of Capital

Q. What rate of return on rate base have you used for ratemaking purposes?

A. As shown on Schedule RR-6, Granite State's weighted average cost of capital is calculated to be 8.32% percent. The weighted average cost of capital is derived from the Company's proposed capital structure, interest rates and related costs for various capital components and represents the rate of return on rate base used in the determination of the Company's revenue requirement, as presented in the testimony of Mr. Hevert.

Q. What did Granite State use for its capital structure?

A. As detailed on Schedules RR-6-1, Granite State puts forth a proforma adjustment reflecting the issuance of additional long-term debt, designed to result in a capital structure of 45 percent debt and 55 percent equity. In Order No. 25,370 in Docket DG 11-040, the Commission stated:

> … [the] structure of 45/55 debt-to-equity ratio is within the reasonable range of precedents and close to the standard hypothetical capital structure of 50/50 often used as a benchmark in rate cases. In addition, as noted by Staff, Granite State is currently earning well below its authorized rate of return and its first base rate case following the transfer will provide an opportunity to adjust the capital structure, as appropriate.

Q. How is the cost of common equity determined?

A. The cost of common equity of 10.5 percent is at the middle of the range of the cost of equity determined by the Company's witness Mr. Hevert. Please refer to Mr. Hevert's testimony for the calculation of the cost of equity capital.

Q. Please explain the derivation of the cost of long-term debt.

A. The calculation of the cost of long-term debt for Granite State is detailed on Schedule RR-6-1, which shows the weighted average cost rate of 5.64 percent that was calculated by using the "Net Proceeds" methodology in accordance with Commission precedent. Please refer to Mr. Hevert's testimony for the calculation of the cost of debt.

VII. STEP INCREASE, RATE PLANS, TARIFF CHANGES

Step Increase

Q. Is the Company proposing a Step Increase as part of its case?

A. Yes. The Company is requesting that the Commission approve a Step Increase to reflect additions to rate base through December 31, 2013. The Step Increase is structured to recover an annual revenue deficiency of $1,250,467 based on capital additions of approximately $9.2 million for the period ending December 31, 2013. The resulting rates from the Step Increase would go into effect concurrent with the permanent increase. The projects and associated estimated costs are shown in Attachment CGM/MRS-5.

Q. Please explain why the Company is seeking a step increase.

A. As explained in Mr. Saad and Mr. Demmer's testimony, the Company will be making significant capital investments during the pendency of this case. The Company is seeking a Step Increase for these capital investments because without this increase, the Company would not have a reasonable opportunity to earn its allowed return immediately upon the conclusion of the case.

The projects and associated estimated costs are shown in Attachment CGM/MRS-5. As shown in the Attachment, approximately $9.2 million of capital investments will be made. Of these, approximately $6.1 million is for various items of electric plant (substation upgrades, regulators, etc.) that are necessary for operation of the electric distribution system, approximately $1.4 million is for building and facilities (capital improvements and security) and $1.7 million is for vehicles which are necessary for the crews in the field.

Q. Please explain the Step Increase revenue requirement calculation.

A. Attachment CGM/MRS-5 contains the revenue requirement for the Step Increase. Line 2 shows the capital additions of $9.2 million, broken out by asset type (FERC classification). Lines 7 and 9 show tax depreciation deduction and book depreciation expense, respectively, in year 1. Line 12 is the difference between the tax and book, and line 13 is the deferred tax amount after year 1. Lines 15-19 compute the rate base reflecting capital cost, accumulated depreciation and ADIT. Lines 21-25 compute the revenue requirement including pre-tax return on rate base, depreciation expense and property tax and insurance costs related to plant in service. The total revenue requirement of $1,508,495 is on line 25; the Company reduced the total by the revenue requirement related to leased vehicles $250,467, which will be replaced by some of the capital additions shown on this schedule.

As discussed by Mr. Gorman, the Company proposes the Step Increase amount of $1,250,467 be recovered on a kWh-delivered basis. The Step Increase rates are presented on Schedule HSG-22.

<u>Rate Plans</u>

A. Storm Fund

Q. What is the purpose of the Storm Contingency Fund?

A. The Storm Contingency Fund (“Storm Fund” or “Fund”) established in DG 06-107 is intended to smooth out the cost to customers of the inevitable impact of major storm events that cause damage to the Company’s electric distribution system.

Q. What level of funding does the Company propose for the Storm Fund?

A. The Company is proposing to recover an annual amount of $2.8 million to be collected via the Storm Fund. This addition comprises $1.6 million in base rates and $1.2 million to be recovered via the Storm Recovery Adjustment ("SRA") Factor. The amount in base rates is designed to recover the average annual cost of storm recovery calculated over the last five years. The amount included in the SRA is designed to recover the current deficit balance in the Storm Fund, $6.7 million, by the end of2019.[3] The current deficit arose because the costs associated with recent storms far exceeded the Storm Fund available to offset the effects of three recent major storms. The three major storms were the (1) August 28, 2011 Tropical Storm Irene, (2) October 29, 2011 "Halloween" Storm, and (3) October 29, 2012 Superstorm Sandy. The deficit balance is projected to be recovered by the end of 2019, which is an unreasonably long period for the Company to be compensated at a rate far below its cost of capital (i.e. the customer deposit rate), for such a significant financial outlay.

In addition, the Company is proposing the following modifications to the Storm Fund:

- The Company is proposing to recover the costs associated with pre-staging personnel and equipment for qualifying major storms, as described in Mr. Saad and Mr. Demmer's testimony. As part of this case, the Company is seeking to recover $300,000 it expended on pre-staging costs for winter storm Nemo which were necessary and prudently incurred given the severity of the storm that was predicted.
- The Company is proposing to recover the costs associated with pre-staging

[3] The SRA will recover this deficit balance assuming future storm recovery costs incurred are $1.6 million annually.

personnel and equipment for qualifying major storms, as described in Mr. Saad and Mr. Demmer's testimony.

- The Company is proposing the carrying charges associated with the Storm Fund deficit balance will accrue at the Company's weighted average cost of capital, as described in more detail below.
- The Company will no longer collect the SRA amount once the Storm Fund deficit balance reaches zero. This could occur by the end of 2019 if annual Storm costs are less than $1.6 million, or later if annual Storm costs exceed $1.6 million; however, the Company would leave the SRA mechanism in place in the event that there is a future need to collect a deficit.

Q. Please provide a brief description of how the Company's Storm Fund operates.

A. The Storm Fund was part of the Commission's Order approving the Merger Settlement Agreement in DG 06-107. This Fund allows for recovery of costs associated with "major storms" experienced by the Company. Major storms are defined as a severe weather event or events causing 30 concurrent troubles (i.e., interruption events occurring on either primary or secondary lines) and 15 percent of customers interrupted, or 45 concurrent troubles. Expenses related to major storm preparation and restoration efforts are charged against the Storm Fund when paid. Customers benefit from the operation of the Storm Fund because it stabilizes the recovery of costs that are unpredictable, subject to extreme fluctuations and beyond the control of the Company.

Since the Storm Fund was established, the Company has experienced seven qualifying Storms: June 2008, December 2008, February 2010, March 2011, August 2011, October 2011, and October 2012. Some of the storms have resulted in a high level of costs, putting the Fund in a substantial negative position. As a result, the Company has requested and received temporary increases to the SRA factor to allow for faster recovery of its costs for these extreme storms. The Commission has allowed for temporary increases to the SRA factor for no less than five years. Recovering the costs of these extreme storms through a temporary increase in rates allows for a timely elimination of the expected deficit, and reduces the carrying charge that customers pay.

Under the original Storm Fund mechanism, the Company's base rates were set at a level that included $120,000 of annual collections to credit the Storm Fund. Granite State's SRA tariff provision is the mechanism by which the Company is authorized to fund the Storm Fund beyond the level provided for in base rates. Presently, the balance of the Storm Fund (whether in a surplus or deficit position) accrues a carrying charge at the customer deposit rate. The carrying charge compensates customers or the Company for the net cash position of the fund. If the fund is in a credit position (cumulative collections from customers exceed cumulative qualifying storm costs charged to the Storm Fund), the carrying charge is accrued on behalf of customers increasing the Storm Fund's credit balance. If, however, the fund is in a deficit position, as it is now (cumulative collections from customers are less than cumulative storm costs charged to the fund), the carrying charge is accrued on behalf of the Company, further increasing the Storm Fund's deficit position.

The Company is proposing to accrue the Storm Fund carrying charge at its weighted average cost of capital to reflect the actual cost to the Company when the Storm Fund is in deficit. When the fund is in surplus the weighted average cost of capital will compensate customers at the same rate of return that the Company's investors are compensated. The current Storm Fund deficit represents a commitment of approximately $6.7 million of the Company's financial resources, equal to a significant portion of annual capital spending. It is appropriate and necessary that the Company be compensated for this cash outlay at a rate representing the true cost of the financial resources that it has been required to commit, i.e., the weighted average cost of capital.

Q. Why is the Company making this proposal to increase the Storm Fund as part of this rate case?

A. This proposal is in response to the Commission's previously planned review of the Storm Fund. In Order 25,307 that resulted from the Company's last Storm Fund filing in DE 11-221, the Commission stated that "Given the long-term problem caused by the unexpected frequency and severity of storms that have been experienced in the past five years, we intend to review the level of Storm Fund contribution in National Grid's next rate case."

Q. How does your proposal translate into the SRA Factor?

A. The proposed SRA Factor equals the annual SRA amount to be recovered, $1.2 million, divided by expected kWh deliveries. The proposed rate is 0.13¢ per kWh, to be in effect until the SRA balance is zero.

Q. In addition to increasing the SRA Factor, is the Company proposing to make any other changes to the Storm Fund?

A. Yes. When a major storm that could impact service is anticipated, Granite State makes certain arrangements, including the pre-staging of crews, to prepare for any service restoration efforts anticipated by the storm. Pre-staging expedites the restoration of service following a storm, which is beneficial to customers. Currently, if Granite State conducts such pre-staging and the storm does not escalate to the level defined as a major storm, there is no mechanism to recover the costs of pre-staging.

To alleviate this loss and to remove the disincentive to pre-stage crews, Granite State proposes that it be allowed to charge the Storm Fund the costs of pre-staging under certain defined circumstances. Specifically, Granite State proposes to establish criteria that will trigger planning activities, including the pre-staging of crews; and to allow associated coststo be charged to the Storm Fund. The details of this proposal are set forth in Mr. Saad and Mr. Demmer's testimony.

B. Property Tax Reconciliation Mechanism

Q. Please explain the Company's proposal for a property tax expense reconciliation mechanism.

A. The Company is proposing to implement a property tax reconciliation mechanism. Under the proposed reconciliation mechanism, actual property tax expenses incurred will be reconciled to the amount included in base rates and the difference will be recovered through a separate rate adjustment mechanism.

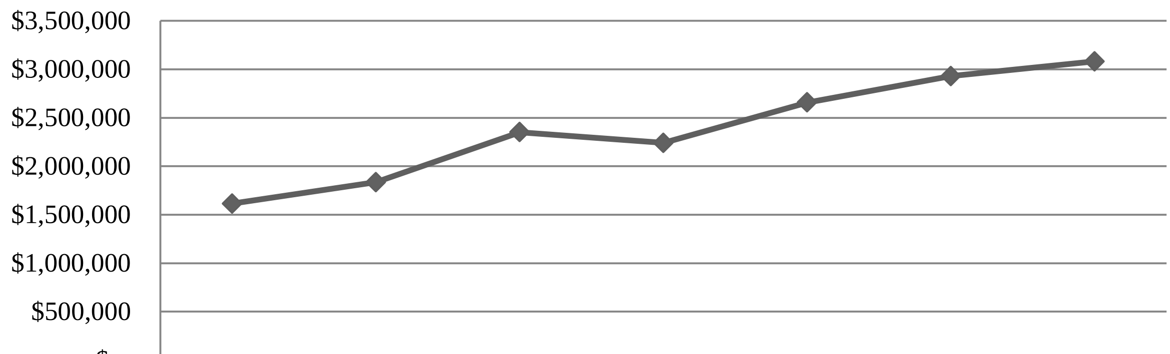
Q. Why is the Company proposing the establishment of a property tax reconciliation mechanism?

A. In recent years, property tax rates have sharply escalated in most municipalities in New Hampshire. The Commission's existing practice is to incorporate the actual property expense during the test year in the cost of service the actual property expense, adjusted by a three-year average increase of property tax expense through the end of the rate year. However, increases in municipal property taxes are consistently rising at a much faster rate than anticipated by the Commission's ratemaking practice, and therefore, are not adequately captured in the existing base rate three-year formula.

Figure 8 provides data from 2006 to 2011 showing the annual level of property tax expense for Granite State. The data indicates the highest level of increase in these expenses in recent years. A consistent pattern of significant increases in this expense is confirmed by data from 2009 and forward. In light of this consistent trend of increasing and volatile municipal property taxes, the use of a composite historical 3-year average increase to calculate the level of representative property tax expense means that the amount included in the Company's rates will be less than the Company's actual property tax expense even as new rates are put into place.

Figure 8

Property Taxes



	2006	2007	2008	2009	2010	2011	2012
Tax Paid	$1,614,238	$1,834,362	$2,350,397	$2,240,806	$2,658,232	$2,930,091	$3,080,755

Q. Why is the property tax expense included in the Company's rates insufficient?

A. Municipal property taxes have been rising rapidly, as shown in Schedule RR-3-14A. Moreover, both tax rates and property valuations are subject to strong upward pressure as municipalities struggle with budgetary issues. Using a fixed rate allowance for property tax based on test year expense escalated by a three-year average percentage increase in the context of a base rate case rather than a more contemporaneous mechanism significantly raises the risk of under-recovery of property tax expense by the Company, the imposition and level of which are not within its control.

Q. Are increases in the property tax rates and valuation the only factors producing an underestimate of representative levels of property tax expenses?

A. No, increases in plant investment levels with the addition of new plant also contribute to the current formula's failure to properly estimate a representative property tax level. Significant increases in plant levels exacerbate the problematic predictive nature of the current ratemaking formula.

Q. Is the Company requesting a permanent change in the ratemaking treatment of property tax expenses?

A. Yes. The Company's revenue requirement in this case would establish a base amount of property tax recovery. A property tax reconciliation mechanism would operate so as to recover the difference between the Company's actual property tax expenses in a given year versus the base recovery level embedded in base rates and refund or surcharge that difference through a separate recovery factor. Thus, the Company's rates will automatically adjust for fluctuations in taxes levied by municipalities and changing investment levels to recover the actual levels of property taxes incurred to provide service to its customers.

Q. Please explain how the recovery factor will function once it is implemented.

A. The Company has included the proforma test year increase to property tax expense resulting in amount of $3,184,358 for rate year expense. Under the proposed reconciling mechanism, any difference between the actual amount of expense and the amount of expense allowed in this case would be recovered from or credited to customers at the end of each year. The December 31 balance, positive or negative, would be collected or refunded through a distribution adjustment charge during the subsequent year.

C. Pension and OPEB Expense Reconciliation Mechanism

Q. Could you please explain why the Company is seeking a pension reconciliation mechanism?

A. The Company is requesting that the Commission authorize the recovery of pension and other post-employment benefits ("OPEB") through a reconciliation mechanism. Under the Company's proposal, the test year amount would be included in base rates subject to an annual reconciling mechanism.

Q. Please explain why the Company is seeking this treatment for pension and benefits expenses.

A. As shown in Schedule RR-3-03, pension and OPEB expenses are a significant expense for the Company, amounting to a rate year expense of $4,089,338 for pension and benefits. Due to factors beyond management's control, it is likely that pension and OPEB expenses in future years will be either significantly greater or significantly less than the test year amounts. Specifically, pension and OPEB expense calculations rely heavily on actuarial assumptions, and other factors to calculate the estimated costs of these benefits. Employee turnover, new hires expected in the next few years, retirement age, life expectancies, administrative expenses, assumed earnings on pension plan assets, and the date on which a benefit becomes fully vested are some of the more important actuarial assumptions. Other factors such as the discount rate employed and fluctuations in the stock market together create significant volatility in pension and OPEB expenses. Because of these circumstances, the Company is requesting the Commission to authorize a reconciliation mechanism for pension and OPEB expenses.

Q. What is your response to concerns raised by Staff and the Commission in Granite States' sister Company, EnergyNorth in Docket DG 10-017 regarding a reconciling mechanism?

A. The Staff indicated in Docket DG 10-017 that it opposes a pension and OPEB reconciling mechanism. The basis for that opposition appears to be that utilities have the ability to determine the level of pension and other post-retirement benefits to offer its employees. However, the Company's ability to control these costs is very limited.

The Company must offer competitive benefits in order to attract and retain a skilled work force to serve its customers and operate its system safely and efficiently. For a substantial number of the Company's employees, the level of benefits is governed by the give and take of union negotiations. Once pension benefits have been agreed to in collective bargaining agreements, the Company is obligated for the costs of these benefits. Thus, these costs become obligations of the Company to existing and future retirees and their dependents.

We believe that the Company's limited ability to affect the level of pension and OPEB benefits is overshadowed by the Company's inability to control the key variables that affect year-by-year benefit costs. The reconciling mechanism would allow the actual pension and OPEB costs to be properly recognized in a timely manner. This approach is fair to both the Company and its customers

The year-by-year costs associated with pension and OPEB obligations is subject to (1) actuarial assumptions/changes and (2) investment returns on plan assets that are beyond the control of the Company. A key actuarial assumption is the discount rate for valuing benefit obligations. This discount rate is re-set each year by the Company's actuaries and auditors according to the prevailing interest rates for long-term corporate bonds. The investment returns on plan assets is another key factor in annual costs. Variability in returns has a direct and often significant impact. OPEB costs are also affected by other factors such as health care inflation and participant mortality.

Q. How would the proposed reconciling mechanism work?

A. The Company's proforma pension and benefits, including OPEB expense for the rate year, totals $4,089,338. Test Year actual expense was $2,017,840. The increase over Test Year actual expense includes $2,118,870 to amortize a pension plan valuation adjustment that was recorded in connection with the acquisition by Liberty Energy NH. Other adjustments resulted in a net decrease to the expense of $101,030.

Q. How do you propose the deferred amount be collected from or returned to customers?

A. The December 31 balance, positive or negative, would be collected or refunded through a distribution adjustment charge during the subsequent year.

Q. Please explain why a pension/OPEB mechanism like the one the Company is proposing is beneficial to customers.

A. As stated previously, pension and OPEB expense is large and has significant volatility. The Company's proposed reconciliation mechanism (1) would allow the Company to recover pension and OPEB costs incurred in providing service to customers and (2) would ensure that customers pay no more and no less than the amounts needed to meet the Company's obligation to employees.

Q. When does the Company propose to implement the pension reconciliation mechanism requested in this case?

A. The Company is proposing to implement the pension reconciliation mechanism as part of the final order in this case. The reconciliation mechanism would continue from year to year thereafter. Please refer to Mr. Smith's testimony for further information regarding the challenges associated with pension and OPEB expense.

<u>Tariff Changes</u>

Q. Has the Company prepared annotated and clean tariff pages showing the proposed changes as required pursuant to Puc 1603 General Tariff Filing Requirements and 1604 Full Rate Case Filing Requirements?

A. Yes. As part of this case, the Company has filed a new tariff, designated as NHPUC No. 19 – Electricity, which supersedes and replaces all pages in the Company's currently effective tariff, NHPUC No. 18 – Electricity. It reflects the proposed rates and changes in the Company's terms and conditions of service.

Q. How are the changes to the tariffs presented?

A. Mr. Gorman presents the proposed rate s in his rate design section of his testimony. Mr. Sherry proposes changes to the tariff that relate to customer charges and fees, such as fees for interest on late payments, fees for disconnect and reconnect of electric service, customer requested meter tests, other special requests from customers, and the

Company's Line Extension Policies. As part of this case the Company is proposing the elimination of the GreenUp Program; removal of Transition Service Cost Adjustment Provision and Load Response Program; to change the name of energy supplied to the customer from Default Service to Energy Service, and finally changes to the Qualifying Facility Tariff.

A. Transition Service Adjustment Provision

Q. Why is the Company proposing to delete the Transition Service Cost Adjustment Provision?

A. The Company is proposing to delete the Transition Service Cost Adjustment Provision because Transition Service has not been offered by the Company since 2006. As a result, there is no longer a need for a Transition Service Cost Adjustment Provision in the Company's Tariff.

B. Load Response Program

Q. How many customers are currently enrolled the Load Response Program?

A. The Company currently has no customers enrolled in the Load Response Program.

Q. Why does the Company propose to eliminate the Load Response Program?

A. The Company is proposing to eliminate the Load Response Program because this ISO sponsored program was eliminated in June of 2012.

C. Change From Default to Energy Service

Q. Why is the Company proposing to change all references to Default Service in its Tariff to Energy Service?

A. The Company is proposing to use the term “Energy Service” in place of “Default Service” in its Tariff to better differentiate between retail sales and wholesale purchases. In Order No. 24,614 (2006), the Commission authorized, but did not compel, electric utilities to use Energy Service to describe the commodity service provided to customers who are not taking service from a competitive supplier. The Company is taking this opportunity to update its retail Tariff to use this term in place of Default Service. The Company agrees with the reasons set forth in Order No. 24,614 that Energy Service would “better describe the service that is being provided to the consumer and decrease possible customer confusion”.

D. Changes to Qualifying Facilities Tariff

Q. Please provide an explanation regarding the proposed changes to the Energy Transactions with Qualifying Facilities Tariff (“QF Tariff”)?

A. The proposed changes to the QF Tariff are intended to reflect the current wholesale market in New England and update the Company’s very stale power purchase rates.

Q. Does the Company have any customers taking service under this Tariff?

A. No. The Company has not had any QF customers since 2006. While the Company does not expect to purchase power from a Qualifying Facility in the near future, the incentives for the development of renewable and alternative generation resources in New Hampshire may result in a QF requesting the Company to purchase its output.

Q. At what rate is the Company proposing to purchase the electric energy from a QF?

A. Since the Company contracts for its Energy (Default) Service commodity requirements through an all-requirements purchase, the Company has no need for the electric energy from a QF. Instead the Company would sell the electric energy output of a QF into the New England electric spot market managed by ISO-NE. Any revenue the Company receives from ISO-NE, less any charges imposed by ISO-NE, and would be paid to the QF owner(s).

Q. Will the Company also make capacity payments to the QF owner(s)?

A. No. Because of the current structure of the capacity market in New England, the Company is unwilling take on an obligation to provide capacity to the market from a resource the Company does not own or operate. If a QF is designed and built to sell both electric energy output and capacity, there are other options that can be pursued in the New England market.

Q. Is the proposed QF tariff consistent with other electric utilities in New Hampshire?

A. Yes. Both the QF tariffs of Unitil Energy Systems, Inc. and Public Service Company of

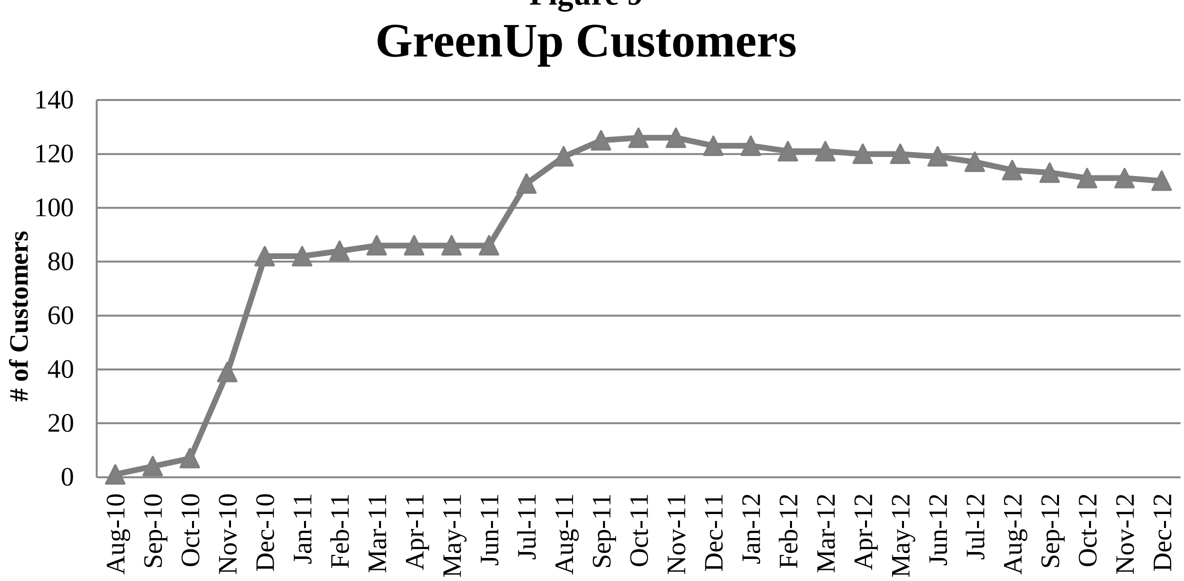
New Hampshire are similar to the Company's proposed QF tariff.

E. GreenUp Program

Q. Please describe the status of the GreenUp program.

A. The Company has not experienced a significant level of participation in the GreenUp program since its inceptions. Figure 9 below depicts the total number of customers subscribing to the GreenUp program since its inception.

Figure 9



Q. Has the Company marketed the program to its customers?

A. Yes, both National Grid (as the previous owner) and the Company post-acquisition included information on the GreenUp program in its bill inserts, which are included in the customer's monthly bill. National Grid and the Company also include information regarding the GreenUp program on their websites.

Q. Does the Company believe the GreenUp program has been successful?

A. No. Even though the program meets the requirements of RSA 374-F:3, V(f), and provides a renewable option for Energy (Default) Service customers, the level of customer participation does not warrant continuation of the program. To date, approximately $37,000 has been spent to the market the program to the Company's customers, yet at the end of the first year, there were only 86 customers enrolled in the program. By the end of 2012, that number had only risen to a mere 110 customers. The Company has participated in discussions among all the electric utilities, Staff and the Office of Consumer Advocate to discuss low or no cost ways to market the program but still have not achieved significant participation in the program.

Q. Are you proposing to end the GreenUp program?

A. Yes. Customers now have more options to support green or renewable resources then they did at the time RSA 374-F:3, V(f) was enacted. Current GreenUp customers that are interested in continuing to directly support renewable resources could do so through direct relationships with renewable suppliers that does not pass through the utility. Given the low participation and these other market options, the Company is proposing to eliminate the GreenUp program.

Q. Doesn't RSA 374-F:3, V(f) require the Company to offer a renewable default service option?

A. Yes. RSA 374-F:3, V(f) requires the Company to offer a renewable default service option but also allows the Company to set a minimum level of customer participation. The Company believes that the low level of participation does not warrant continuation of the program. In addition, the Company believes it would not be a wise use of resources to apply more funds to marketing the program when so few customers have expressed interest in the program, particularly given that the marketing costs are incurred by all of the Company's customers.

Q. How does the Company propose to end the GreenUp program?

A. The Company proposes to end the GreenUp program at the end of a calendar quarter. This would allow the GreenUp suppliers to easily provide renewable energy credits ("RECs") from the applicable NEPOOL-GIS trading period. In addition, the Company would send letters to each GreenUp customer notifying them about the end of the program. The letters would also include a list of competitive energy suppliers on the Commission's website that offer green or renewable options in the event that customers wish to directly make such purchases.

VIII. RATE CASE EXPENSES

Q. How do you propose to recover the expenses associated with this rate case?

A. Consistent with Order 25,370, Granite State is allowed to recover up to $300,000 in rate case expenses, plus the cost associated with a depreciation study. The Company proposes to recover the total cost associated with this rate case over one year, through a rate case surcharge.

Q. Has the Company determined how it will structure the rate case surcharge?

A. Yes. Consistent with Commission practice, the rate case surcharge will be a charge per kWh, applied to all rate schedules. Subject to Commission approval, the charge will be a temporary charge, and will be set at a level to recover the costs over a one-year period. The revenue collected will be fully reconciled with the costs incurred. At the end of the recovery period, the Company will file with the Commission a reconciliation of the surcharge, including a recommendation for treatment of any under or over recovered balances remaining at the end of the recovery period.

Q. Please describe the nature of these costs.

A. The costs to be incurred for the rate case are incremental, external costs. The costs are primarily for services such as outside consulting services to assist with the preparation and presentation of this rate case, including the development of studies on various matters required to establish appropriate rates for the Company's customers. The Company obtained competitive bids from outside consultants in order to contain costs and provide a basis to evaluate the overall reasonableness of the rate case expenses. A list of these outside services and their estimated costs are shown in Attachment CGM/MRS-7.

Q. Why does the Company believe it is appropriate to recover the costs over one year?

A. The level of rate case expense in this case, $390,000, is well below what other utilities often incur and thus we believe it is appropriate to have a shorter recovery period.

Q. How are rate case expenses accounted for?

A. The Company defers all costs associated with the case as they are incurred during the course of the proceeding for future recovery in a rate surcharge.

IX. EFFECTIVE DATE, BILL IMPACT

Q. How and when is the Company proposing that these rates be implemented?

A. Consistent with the Commission's rules on the implementation of rate changes, the Company is proposing that rate changes as discussed in Mr. Gorman's testimony be made effective for usage on and after March 29, 2013.

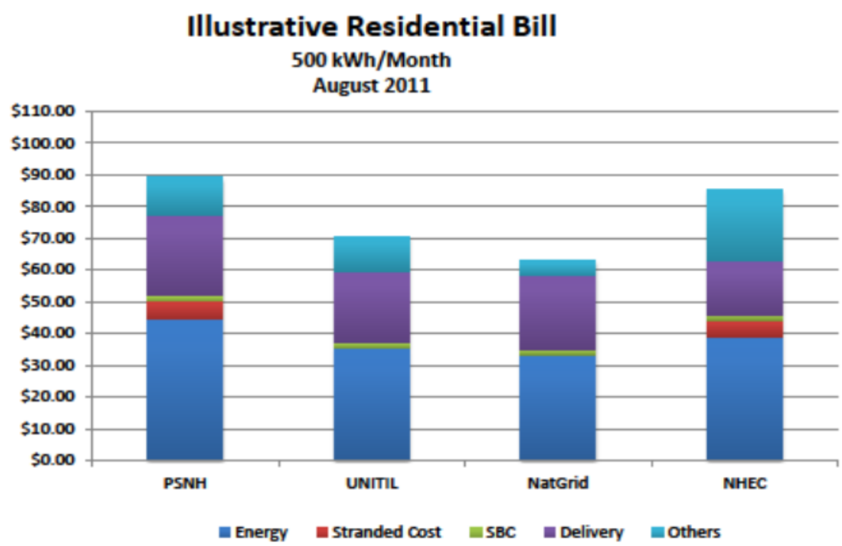
Q. What goals has the Company set in terms of the establishment of rates coming out of this proceeding?

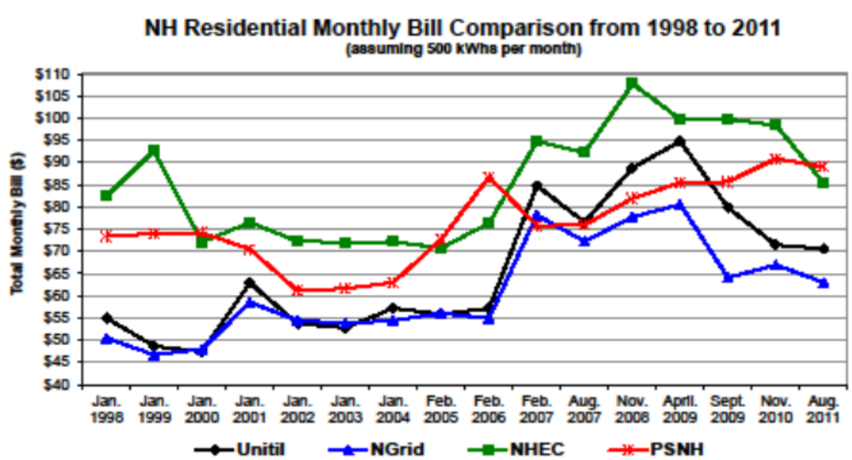
A. The goals of the Company are to ensure that its current costs are based on the costs of the

Company, and to establish rate designs that will move the Company closer to the rates of the other electric distribution companies operating in New Hampshire, in other words, closer to the other 94% of the electric customers in New Hampshire.

Q. How does the Company's rates compare to other electric distribution companies in New Hampshire?

A. Granite State's rates are among the lowest in New Hampshire. Below are charts from the Commission's Biennial Report as of June 30, 2011. They clearly illustrate that based on 500 kWh/Month an average residential bill for Granite State (formerly National Grid) is in the range of $10.00 to $30.00 less than the other companies do.


Illustrative Residential Bill
500 kWh/Month
August 2011
$110.00
$100.00
$90.00
$80.00
$70.00
$60.00
$50.00
$40.00
$30.00
$20.00
$10.00
$0.00
PSNH
UNITIL
NatGrid
NHEC
Energy
Stranded Cost
SBC
Delivery
Others


NH Residential Monthly Bill Comparison from 1998 to 2011
(assuming 500 kWhs per month)
Total Monthly Bill ($)
$110
$105
$100
$95
$90
$85
$80
$75
$70
$65
$60
$55
$50
$45
$40
Jan. 1998
Jan. 1999
Jan. 2000
Jan. 2001
Jan. 2002
Jan. 2003
Jan. 2004
Feb. 2005
Feb. 2006
Feb. 2007
Aug. 2007
Nov. 2008
April. 2009
Sept. 2009
Nov. 2010
Aug. 2011
Unitil
NGrid
NHEC
PSNH

X. CONCLUSION

Q. Does this conclude your testimony?

A. Yes, it does.