STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: NEW ENGLAND GAS COMPANY'S DISTRIBUTION ADJUSTMENT CLAUSE : DOCKET NO. 3690

REPORT AND ORDER

I. NEGAS' AUGUST 1, 2005 FILING

On August 1, 2005, the New England Gas Company ("NEGas"), a division of Southern Union, filed updated factors to the Distribution Adjustment Clause ("DAC") for effect November 1, 2005. NEGas' proposed DAC would decrease annual the bill for the average residential heating customer of NEGas by $5 per year.

In support of its filing, NEGas submitted pre-filed testimony by Peter Czekanski, Director of Pricing for NEGas. Mr. Czekanski explained that the DAC includes an annual system pressure factor related to liquefied natural gas ("LNG"), a Demand Side Management ("DSM") factor, a Low Income Assistance Program ("LIAP") factor, an Environmental Response Cost ("ERC") factor, an On-System Margin Credit factor, a Weather Normalization factor, an Earning Sharing factor, and a Reconciliation factor for the previous year.[1]

As for the system pressure factor, NEGas proposed to maintain the factor at $0.0054 per therm. The factor is based on the commodity related portion of LNG costs projected from November 2005 through October 2006. In regards to DSM, Mr. Czekanski explained that the DSM program was established in Docket No. 2025 to promote the development of energy-efficient natural gas technologies that increase utilization of natural gas during periods of low demand. He noted that increased off-peak usage reduces the unit cost of gas for all customers by generating distribution revenues to

[1] NEGas Ex 1: (Czekanski's direct testimony), pp. 2-4.

support fixed costs associated with resources needed during peak periods. He explained that NEGas is a participant in the Rhode Island Greenhouse Gas initiative. NEGas proposed no change to the existing level of funding, which is $300,000 annually. He noted that NEGas has $1,274,475 available, of which $378,386 was designated for approved projects awaiting final customer implementation and another $572,784 of rebates are under review. Thus, there is a balance of $314,305 carried over from fiscal year 2005 and the annual funding of $300,000. For the LIAP, Mr. Czekanski stated that this factor provides additional funding to LIHEAP and to a low income weatherization program. He noted that annual funding in distribution rates for LIHEAP and weatherization are $1,585,000 and $200,000, respectively. NEGas proposed no change to the current level.

In relation to the ERC factor, NEGas proposed a decrease in the factor to ($0.0019) per therm. This factor reflects a 10 year amortization of environmental response costs. There is $1,310,000 of annual ERC funding embedded in base rates. The net environmental costs of $616,133 for fiscal year 2005 resulted in a reduction of $693,867. In the area of non-firm margins, NEGas proposed a credit of ($0.0033) per therm. Mr. Czekanski calculated that NEGas recorded $3,152,849 of non-firm margins or $1,552,849 more than the $1.6 million threshold. This results in 75%, or $1,164,637, to be credited to customers and 25%, or $388,212, to be retained by shareholders. As to weather normalization, NEGas proposed a credit factor of ($0.0045) per therm. Mr. Czekanski noted that during the winter period of November 2004 through April 2005, the

weather was colder than normal and there were 178 degree days in excess of the threshold. As a result, $1,602,000 was to be credited to customers.[2]

Mr. Czekanski explained that the earning sharing calculation had not been completed, because NEGas' financial data for the fiscal year ending June 30, 2005 had not been completed. NEGas will supplement this filing and provide the calculation no later than September 1, 2005. This filing will include the adjustments made at the May 2005 open meeting by the Commission to NEGas' earning sharing calculation for fiscal year 2004. Also, Mr. Czekanski stated that NEGas incurred no service quality penalties for fiscal year 2005. As for the reconciliation factor for fiscal year 2004, NEGas proposed a factor of $0.0014 per therm. The total undercollection for the previous reconciliation factor was $86,883.[3]

II. NEGAS' SEPTEMBER 1, 2005 FILING

On September 1, 2005, NEGas submitted the direct testimony of Robert Riccitelli, Manager of Financial Reporting and Budgeting for NEGas, and the supplemental testimony of Peter Czekanski. Mr. Riccitelli provided the calculation of NEGas' earnings under the earning sharing mechanism ("ESM"). He determined that for the fiscal year ending June 30, 2005, the return on equity ("ROE") was 11.39 percent, and therefore ratepayers were entitled to a credit of $112,282 or ($0.0003) per therm for the period November 1, 2005 through October 31, 2006. NEGas determined that its net income available for common equity for the fiscal year ending June 30, 2005 was $12,084,575. This was based on various adjustments to NEGas' operating revenues and expenses. First, fiscal year 2005 had a colder than normal winter resulting in $1,602,000 to be

[2] Id. pp. 4-10.
[3] Id. pp. 10-16.

returned to ratepayers through the Weather Normalization Clause. As a result, the operating income for purposes of the ESM was reduced by $1,602,000. Second, NEGas' portion of non-firm margins are excluded from fiscal year 2005, or $372,499 from the ESM. Third, NEGas and the Division agreed to remove stored gas inventory from the rate base and to eliminate carrying costs on stored gas inventory from revenues, which decreases operating revenues by $2,411,480. Fourth, NEGas excluded unbilled revenues from the ESM, decreasing operating revenues by $2,495,940. Fifth, NEGas excluded the effect of FY 2004 ESM over-earnings and an estimate of FY 2005 ESM over-earnings for a total of $142,653. Sixth, NEGas included the investors' share of annual net merger savings, or $2,049,000 in operating expenses. Seventh, NEGas excluded 75 percent of NEGas' incentive compensation, and 100% of management's safety/customer-service bonus, which decreased operating expenses by $455,803 and excluded all expenses related to corporate level incentive compensation. Eighth, NEGas excluded all lobbying expenses from the ESM. Ninth, NEGas decreased gas costs by $573,422 for the prior year DAC adjustment. Tenth, NEGas booked all expenses relating to the mercury-release incident below the line and thus, their expenses were excluded from operating expenses for the purpose of calculating the earnings sharing. Eleventh, NEGas excluded 50 percent of advertising and public relations, which decreased operating expenses $48,721. Twelfth, for other interest expense, NEGas included only those costs associated with customer deposits. Lastly, NEGas excluded amounts relating to Contributions in Aid of Construction ("CIAC") from rate base.[4]

Also, for the calculation of the accumulated deferred income taxes ("ADIT"), NEGas calculated deferred income taxes related to accelerated depreciation and excluded

[4] NEGas Ex.3 (Riccitelli's direct testimony), pp. 2-7.

amounts booked pursuant to FAS 109 for the Rhode Island portion of NEGas. Thus, NEGas rolled forward the ADIT balance related to depreciation (tax versus book) less FAS 109 from the time of the merger (September 30, 2000) through June 30, 2005. The roll-forward calculation includes the actual ADIT for the six months ending December 31, 2004 and an estimate for the six months ending June 30, 2005. In addition, for the ESM, NEGas utilized the statutory tax rate of 35 percent for calculating NEGas' federal income taxes. Mr. Riccitelli utilized an imputed capital structure of: 43.6 percent common equity, 1.9 percent preferred stock, 45.7 percent long-term debt, and 8.8 percent short-term debt. He also utilized the following cost of capital rates: 11.25 percent for common equity, 9.93 percent for preferred stock, 7.81 percent for long-term debt, and 3.13 percent for short-term debt, which is based on the recent 12 month average cost of short-term debt for Southern Union. Also, NEGas included funds associated with the allowance for funds used during construction in calculating operating income.[5]

In calculating the rate base, NEGas used a five-quarter average ending June 30, 2005. However, Mr. Riccitelli excluded environmental response costs and prepaid taxes from the rate base. He did include construction work in progress in the rate base and computed the working capital allowance pursuant to the method approved in Docket No. 2286. Also, the deferred debits in the rate base included Y2K costs, amortized at the rate of $240,000 per year, and excluded the costs associated with the Legacy customer-information systems. NEGas also excluded Stored Gas Inventory and CIAC from the rate base calculation. He noted that earnings between 11.25 percent ROE and 12.25 percent ROE are shared equally between shareholders and ratepayers while earnings above 12.25 percent are shared by giving 75 percent to ratepayers and 25 percent to

[5] Id. pp. 5-9.

shareholders. As a result, Mr. Riccitelli calculated $112,282 to be returned to ratepayers. As for the ESM calculation for fiscal year 2004, Mr. Riccitelli calculated an adjustment of $7,480 in earnings sharing as a result of the May 31, 2005 Open Meeting decision.[6]

Mr. Czekanski updated the proposed DAC. He updated the LNG commodity costs from $1,945,575 to $2,020,394 or $0.0056 per therm for the System Pressure Factor. Mr. Czekanski also included the calculation for the ESM of $112,282, partially offset by the $7,480 adjustment for fiscal year 2004. Accordingly, there is a proposed DAC credit factor of $0.0030 per therm. The impact of the proposed DAC on a typical customer bill is a 0.3 percent decrease or $5 per year.[7]

III. DIVISION'S DIRECT TESTIMONY

On October 14, 2005, the Division of Public Utilities and Carriers ("Division") submitted the direct testimony of Bruce Oliver. Mr. Oliver discussed all elements of the DAC except the ESM. For the system pressure factor, Mr. Oliver determined that NEGas' proposed factor of $0.0565 per Dth filed on September 1, 2005 was mathematically accurate. In addition, Mr. Oliver indicated that NEGas' LNG System Pressure Report filed on July 29, 2005 showed that for the winter of 2004-05 NEGas' LNG use was in compliance with the allocation of 20.39 percent of LNG costs to maintain the system. He also agreed with the procedure proposed by NEGas, which will forecast system balancing costs which exclude LNG dispatched for economic reasons and will exclude economically dispatched LNG volumes and costs before computing LNG costs for system balancing in the DAC. For the DSM factor, Mr. Oliver noted that $1,274,475 remains unexpended. Accordingly, Mr. Oliver found the current DSM

[6] Id. pp. 9-11.
[7] NEGas Ex. 2 (Czekanski's supplemental testimony), pp. 1-3.

funding was more than adequate. Also, he stated that since interest is not provided for unexpended DSM balances, it could be argued that the unexpended balance of DSM funds is providing NEGas with cost-free working capital. For the LIAP factor, Mr. Oliver stated that the LIAP funding in base rates is $1,793,901 per year. He noted that NEGas will have a carry forward from fiscal year 2005 of $202,369 in this account. Also, he stated that providing greater assistance to low-income customers through gas rates will only amplify problems for other ratepayers. Instead, Mr. Oliver stated that low-income customers should look to the state and federal legislatures for governmental assistance. Mr. Oliver found no reason to question NEGas' level of LIAP funding.

Regarding the ERC factor, Mr. Oliver noted that NEGas is seeking approval to return a credit amount of ($693,867) through the DAC. This negative amount reflects: a 10-year amortization of $12,510,252 of ERC costs incurred through the end of fiscal 2002; a 10-year amortization of ($6,012,673) of ERC costs for fiscal 2003; a 10-year amortization of ($472,960) of ERC credits for fiscal 2004; a 10-year amortization of $136,707 of net ERC credits for fiscal 2005; and a deduction of $1,310,000 for budgeted base rate recovery of ERC costs. Based on a data response from NEGas, he stated that all costs associated with the Tidewater site mercury release incident which totaled $8,640,215 are not included in the ERC factor. He made no adjustment to the ERC factor.[8]

In the area of on-system margin credits, Mr. Oliver accepted NEGas' calculation and noted the increase in non-firm gas sales was due to a new gas-fired power plant and an increase in oil prices. As for the weather normalization factor, Mr. Oliver found NEGas' proposed factor to be accurate. Also, Mr. Oliver found NEGas' proposed DAC

[8] Div. Ex. 1 (Oliver's direct testimony), pp. 3-15.

reconciliation factor to be appropriate. In conclusion, Mr. Oliver stated that the Commission should accrue interest monthly on unexpended DSM funds thereby increasing the DSM balance by $30,000 to $35,000 and the DSM credit factor from ($0.0030) to ($0.0031) per therm, the overall DAC credit.[9]

IV. GEORGE WILEY CENTER

On October 12, 2005, the George Wiley Center submitted the prefiled testimony of John Howat, an outside consultant with experience in low-income consumer issues.[10] Mr. Howat noted that in Docket No. 3696 NEGas was seeking to raise the typical residential heating customers' bills by $345 annually. He stated that increasing heating bills will exacerbate the affordability of energy for low-income households. As a result, there will be higher customer arrearages and more service disconnections which could impact consumers' health and safety.

Mr. Howat indicated that many low-income families pay about three times the percentage of their income on home energy as do median income families. Also, Mr. Howat noted that federal LIHEAP payments to Rhode Island have not kept pace with recent energy price increases, and in fiscal year 2005 the initial allocation was $12.8 million for Rhode Island. He discussed that the number of children living in poverty in Rhode Island had increased from 16.7 percent in 2003 to 20.7 percent in 2004 and that 12.8 percent of Rhode Islanders were living in poverty in 2004. Mr. Howat stated that as of July 31, 2005, 1,080 protected accounts, which have been terminated since the end of the moratorium, had not been restored. Also, he noted that as of August 31, 2005, 63 percent of payment plans had been broken. Mr. Howat emphasized

[9] Id. pp. 15-23.
[10] No objection was made to the motion to intervene by either the George Wiley Center or the Attorney General, and thus, the motions were granted.

that although Rhode Islanders' home energy expenditures are within the range of the other New England states, Rhode Island has second highest percentage in New England of population below 125% of the Federal Poverty level. Also, he noted that Rhode Island's supplemental energy expenditures were only about $37 per low-income person, which is lower than any other New England state. In conclusion, Mr. Howat recommended a targeted natural gas discount program for LIHEAP participants along with an effective arrearage management program with funding from federal and non-federal sources, including a non-by passable volumetric charge on all of NEGas' sales to end-use customers.[11]

V. HEARINGS ON NON-ESM

Following published notice, public hearings were conducted on October 25 and 26, 2005 at the Commission's offices at 89 Jefferson Boulevard, Warwick, Rhode Island. The following appearances were entered:

FOR NEGAS	:	Cheryl Kimball, Esq.
FOR DIVISION	:	Leo Wold, Esq. Special Assistant Attorney General
FOR ATTORNEY GENERAL	:	William Leuker, Esq. Special Assistant Attorney General
FOR GEORGE WILEY	:	B. Jean Rosiello, Esq.
FOR COMMISSION	:	Steven Frias, Esq. Executive Counsel

At the October 25, 2005 hearing, NEGas presented, as its witness, Mr. Czekanski. Under cross-examination, Mr. Czekanski stated that no costs associated with the mercury spill are in the environmental response costs in the DAC. He also stated the DSM funds

[11] GWC Ex. 1 (Howat's direct testimony), pp. 3-8.

have had a balance of over $1 million but no interest is accrued on this balance for the benefit of ratepayers. Also, Mr. Czekanski stated if interest was incurred on any unexpended balances for DSM it should also be accrued for funds disbursed prior to collection of the whole amount by NEGas such as LIAP. However, Mr. Czekanski admitted a working capital allowance was already included in the DAC for LIAP.[12]

Under cross-examination by counsel for the George Wiley Center, Mr. Czekanski explained that through the DAC, NEGas will match $39 for every $100 of federal money that the State Energy Office disburses to low-income customers. He also indicated NEGas has not increased the level of low-income assistance since the amounts were set in Docket No. 3401. Mr. Czekanski concurred that it costs approximately $75 for NEGas to disconnect and then restore gas service, but he explained that this is a better approach then allowing bad debt to accumulate.[13]

Under cross-examination by the Commission, Mr. Czekanski admitted that the DSM program is not intended to reduce consumption but rather to increase consumption during non-peak periods to recover fixed costs so that all customers benefit. Mr. Czekanski acknowledged that approximately $614,000 of DSM funds have not been allocated or committed and he indicated NEGas would not object to transferring these unused DSM funds to LIAP.[14]

Mr. Oliver testified on behalf of the Division. Mr. Oliver estimated that requiring a short-term debt interest rate on the unexpended balance of DSM funds would give the ratepayers an additional $35,000 this year. Mr. Henry Shelton testified on behalf of the George Wiley Center. He stated that funds for the Percentage of Income Payment Plan

[12] Tr. 10/25/05, p. 21-25.
[13] Id., pp. 34, 36, 41, 44
[14] Id., pp. 70-72, 77.

("PIPP") ended when there was a lack of federal funding and during the PIP program utility service shut-offs still occurred.[15]

The following day, the George Wiley Center presented John Howat as its witness. Under direct examination, Mr. Howat indicated he did not have an estimate of the cost to ratepayers for creating an energy arrearage forgiveness program for low-income households and did not have a specific amount for his proposed volumetric charge to support such a program. Mr. Howat stated he was unaware of the Commission ever establishing a surcharge to benefit low-income households without a legislative mandate.[16]

At an open meeting on October 26, 2005, the Commission reviewed the evidence and adopted a DAC credit factor of ($0.0031) per therm on an interim basis pending a decision on the ESM portion of the DAC. Also, a majority of the Commission reallocated the unspent DSM funds of $614,000 to LIAP.

VI. DISCOVERY DISPUTE

On November 22, 2005, the Attorney General filed a motion to compel NEGas' response to the Attorney General's first set of data requests. In support of its motion, the Attorney General stated that the information was needed in order to determine if the ERC factor contains only costs associated with the proper disposal of old mercury regulators and meters. Also, the Attorney General indicated that the Attorney General, the Division and the Commission have not been able to verify through documentation that the

---

[15] Id., pp. 114, 127-128.
[16] Tr. 10/26/05, pp. 6, 11, 27.

expenses related to the Tidewater site mercury release incident are not in any way being passed on to its ratepayers.[17]

On December 8, 2005, NEGas filed a response to the Attorney General's motion. NEGas stated that the ERC does not include costs associated with the Tidewater incident, and since the inception of the ERC in 1997, the costs recovered for mercury removal relate only to the cost of removal of equipment from customer premises and disposal of material off-site of company property. NEGas reiterated that expenses related to the Tidewater incident are not included in the ESM calculation and expressed its anticipation that the Division will take action it feels necessary in this proceeding to verify NEGas' statements.[18]

On January 19, 2006, the Attorney General filed his position on the ESM. The Attorney General stated that the Division's staff was allowed access to NEGas' records with regards to the expenses included in the calculation of the ESM, and that the Division is satisfied that costs of $8,640,000 related to the Tidewater incident are excluded from the ESM calculation. However, the Attorney General supported the Division's recommendation that a portion of NEGas' administrative and general expenses should be excluded as attributed to the Tidewater incident. As a result, the Attorney General stated that he would not pursue his motion to compel unless NEGas objects to the Division's recommendation. Lastly, the Attorney General indicated he agreed with all of the Division's recommendations regarding the ESM calculation.[19]

---

[17] A.G.'s motion to compel (11/22/05).
[18] NEGas' response (12/8/905).
[19] A.G.'s ESM position (1/19/06).

VII. DIVISION'S ESM TESTIMONY

On January 19, 2006, the Division submitted the pre-filed direct testimony of David Effron. Mr. Effron discussed the ESM calculation. Mr. Effron increased the excess revenue to be credited to the DAC from $112,000 to $612,000. For operating income, Mr. Effron made various adjustments to operating and maintenance expense. First, in the area of legal fees, the Division reduced expenses by $223,319 for the services performed by Kaspwitz, Benson, Torres & Friedman as well as Watson, Bishop, Lathrop and Brophy because NEGas admitted in a data response that these expenses should not have been included in the FY 2005 ESM calculation. Second, the Division indicated that NEGas spent $574,000 in FY 2005 to review all of the company's health, safety and environmental policies to assure consistency where feasible across all divisions and subsidiaries. This resulted in an up-to-date regulations and procedures manual. The Division recommended normalizing these costs by spreading them over three years since the expense was unusual and non-recurring. This reduced the cost by two-thirds for the ESM calculation. Third, the Division noted that Southern Union incurred $3,341,013 of supplemental retirement costs in the second half of fiscal year 2005 which was much greater than the $172,674 incurred in the first half of FY 2005. In a data response, NEGas explained that the plan was terminated in the second half of FY 2005 and as a result of the termination, it was necessary to book an accrual for future payouts related to the plan. Since the termination of the retirement plan is anticipated to produce future savings, and the cost of termination of the plan is a non-recurring expense, the Division spread the cost of terminating the supplemental retirement plan over three years. As a

result, after allocation to NEGas, the Division reduced the operation and maintenance expense by $135,000.[20]

In the area of operation and maintenance expense, the Division also examined costs incurred by NEGas as a result of the mercury release incident at the Tidewater site. The Division stated that NEGas had recorded $8,640,000 in mercury related costs "below-the-line" and was thus excluded from operating expenses for the ESM. These mercury related costs were for clean-up remediation, legal fees, security, aid to displaced persons, and Southern Union's project management and media relations activities. However, NEGas did not allocate any time devoted by personnel to below-the-line, because according to NEGas, the time devoted by NEGas personnel was negligible and was, in effect, uncompensated overtime put in by salaried personnel outside of the time spent performing their regular jobs. Mr. Effron disagreed with NEGas' approach because he did not believe that NEGas' management and administrative personnel expended only minimal time on the mercury incident and only after their normal duties were completed. Mr. Effron stated that a portion of Administrative and General Salaries (Account 920) and Office Supplies and Expenses (Account 921) should be allocated to the mercury incident. Mr. Effron explained these two accounts had a net allowable expense of $13,219,000 and in relation to total operation and maintenance expense, the mercury related expenses are 2.66% of the sum of the mercury related expenses and all "above the line" operation and maintenance expense. Mr. Effron applied this 2.66% allocation factor to the allowable expenses of $13,219,000 and thus, he recommended that $352,000 in administrative and general expense be allocated to the mercury incident and excluded

[20] Div. Ex. 2 (Effron's direct testimony), pp. 1-8.

from the ESM calculation. As a result, Mr. Effron calculated net income of $12,773,000 available for common equity.[21]

For the rate base, Mr. Effron made two adjustments. First, Mr. Effron noted that NEGas acknowledged an error in its statement of the environmental accrual as of June 2004. Since the unspent accrual for expected future environmental expenditures is one element of the depreciation reserve, the correction of the error diminishes the average depreciation reserve for FY 2005 by $1,101,000. Second, Mr. Effron noted that NEGas' calculation of the average balance of accumulated deferred income tax (ADIT) in FY 2005 forecasts a decrease during the last six months of FY 2005. Mr. Effron stated that NEGas has not provided adequate evidence to conclude that a decrease will actually occur. He noted that in each of three prior fiscal years, there had been a subsequent true-up to increase the balance of ADIT. Mr. Effron adjusted the ADIT on the assumption that the balance would not decrease in the last six months and the subsequent accrual true-up would be equal to the average true-up for the last three fiscal years. As a result, he increased the balance of ADIT by $309,000. Mr. Effron calculated a rate base of $244,189,000 and a return on common equity for FY 2005 of 12.00%, which equates to $612,000 of excess revenue to be returned to ratepayers through the ESM factor in DAC of $0.0017 per therm.[22]

VIII. NEGAS' REBUTTAL TESTIMONY

On January 30, 2006, NEGas submitted the pre-filed rebuttal testimony of Robert Riccitelli. Mr. Riccitelli calculated a revised return on equity of 11.77 percent, which results in a credit through the DAC totaling $423,222. Mr. Riccitelli agreed with Mr.

[21] Id., pp. 8-12.
[22] Id., pp. 12-15.

Effron's adjustments to exclude $223,319 in legal fees from operations and maintenance expense, and the adjustment to reduce the depreciation reserve by $1,101,000. He also agreed with the three-year amortizations for the costs of NEGas' comprehensive review of health, safety and environmental policies as well as termination of the supplemental retirement plan.

NEGas disagreed with the other recommendations of the Division. Regarding the Division's allocation of $352,000 from administrative and general ("A & G") expense to the mercury incident, Mr. Riccitelli stated that NEGas' decision to exclude costs associated with the mercury incident from the ESM calculation was based on NEGas' recognition that regulators would view the mercury related costs as not part of the cost of service but rather as incremental costs to be excluded from ESM so as not to impact customers. However, Mr. Riccitelli argued that allocating normal recurring A & G expenses to the mercury incident would allow customers to benefit from the mercury incident through a reduction in normal O & M expense levels. Mr. Riccitelli emphasized that a very limited number of individuals in NEGas were involved in the incident and there is no evidence these individuals failed to perform their normal duties at NEGas or that NEGas' operations were negatively affected.[23]

Although NEGas' position is that no allocation of A & G expenses should be made to the mercury incident, NEGas offered an alternative calculation of an amount if the Commission deems it appropriate to do so. First, Mr. Riccitelli took the salary levels of the top ten salaried officers and directors of NEGas which includes the individuals called upon to assist in the mercury incident and then multiplied the compensation by 10 percent, which represents the upper bound of the amount of time in a month that an

[23] NEGas Ex. 4 (Riccitelli's rebuttal testimony) p. 1-6.

employee may have spent on issues relating to the incident. Second, he multiplied the total by three months which is the total number of months over which the event spanned. Third, he allocated employee benefit costs as well as A & G overhead costs and derived a total of $39,450 which could be attributable to the mercury incident under the Division's theory.[24]

Regarding ADIT, Mr. Riccitelli first updated his calculation of ADIT for the six-month period January 1, 2005 through June 30, 2005 which revises NEGas' calculation from a reduction of $211,369 to a decrease of $18,470. Mr. Riccitelli explained that the original estimate for a reduction of $211,369 to ADIT was based on the fact that all bonus depreciation tax deduction allowances ended on December 31, 2004. As a result, NEGas' tax depreciation on qualified assets placed in service after September 11, 2001 were significantly greater than the depreciation expense taken on NEGas' books based on the composite method of depreciation. When tax depreciation amounts are greater than NEGas' book depreciation expense in any year, there will be an increase in the balance of accumulated deferred income taxes, which caused previously significant increases in ADIT balances for fiscal years 2001 through 2004. However, with the expiration of bonus depreciation allowances at the end of 2004, NEGas anticipates that it would have arrived at the point of reversal when book depreciation would be greater than tax depreciation going forward, and thus ADIT balances would begin to decline. As for the Division's proposal on ADIT, Mr. Riccitelli stated that although the Division's instruction regarding the proposed reduction in the ADIT balance is on point, the magnitude of the ADIT increase proposed by the Division is not appropriate. He explained that the Division's proposal inherently assumes that the level of bonus

[24] Id., pp. 6-8.

depreciation that has been available to NEGas for the past several years will continue to be available in the first six months of 2005. He noted that this is not accurate because bonus depreciation ended on December 31, 2004. Therefore, ADIT balances will no longer increase at the rate they have in the past several years, but in fact these balances are likely to begin to decline in the near future.[25]

IX. DIVISION'S SURREBUTTAL TESTIMONY

On February 10, 2006, the Division submitted the pre-filed surrebuttal testimony of David Effron. First, Mr. Effron stated that, absent detailed time records for FY 2005, it is not possible to know how much time management and administrative employees spent on the mercury incident. Therefore, Mr. Effron maintained that it is necessary to develop a method to allocate A & G expenses to the mercury incident, and he stated that his method was reasonable. Second, Mr. Effron stated that NEGas has offered no evidence that the true-ups for ADIT were booked as the result of bonus depreciation. Therefore, he maintained that his proposal to adjust ADIT for true-ups based on how it has regularly been booked in prior years by NEGas is reasonable. However, Mr. Effron did accept NEGas' minor decline in ADIT for the second half of FY 2005.[26]

X. ESM HEARING

On March 2, 2006, the Commission reconvened its hearing in the DAC proceeding to review the ESM. Ms. Sharon Partridge, Vice President of Finance, adopted the testimony of Mr. Riccitelli and testified on behalf of NEGas. Under cross-examination by Division counsel, Ms. Partridge stated that Southern Union was primarily involved in the mercury incident and not the management of NEGas. Ms. Partridge also

[25] Id., pp. 8-10.
[26] Div. Ex. 3 (Effron's surrebuttal testimony), pp. 1-3.

indicated that only 10.9 percent of the expenses included in Accounts 920 and 921 could even remotely be connected to the mercury incident which was limited to the executive, finance, legal, environmental and publications departments. Under cross-examination by the Attorney General's office, she acknowledged that some administrative time has been spent dealing with the aftermath of the mercury incident. However, Ms. Partridge stated that NEGas personnel do not allocate their costs to specific types of jobs that are above and beyond the normal workday. Under redirect examination, Ms. Partridge explained that if 10.9 percent is multiplied towards $352,000, the amount suggested by Mr. Effron, then the adjusted allocation would be closer to $38,000 which is similar to Mr. Riccitelli's alternative recommendation of $39,450.[27]

Under cross-examination by the Commission counsel, Ms. Partridge explained that the difference regarding ADIT is the size of the true-up, and if the estimate of ADIT is too low, the higher actual number would be reflected in the next year's ESM calculation. Also, Ms. Partridge characterized the time spent on the mercury incident by NEGas' personnel as minimal. As for pensions, Ms. Partridge acknowledged that pursuant to FAS 87 NEGas expensed $4.4 million in pension expense but only contributed $4 million in cash to its pension fund in FY 2005, and that the ESM calculation is based in the FAS 87 amount. Ms. Partridge was not sure if placing less cash into the pension fund than was expensed would increase the unfunded liability of the pension plan. Under cross-examination by the Commission, Ms. Partridge stated she didn't believe that the company would come back and ask the ratepayers to pay for the unfunded liability as long as NEGas meets all of the requirements of FAS 87 and ERISA. Under further cross-examination by Commission counsel, Mr. Partridge did not dispute

[27] Tr. 3/2/06, pp. 18-19, 28, 41-42, 51-52.

that Valley Gas' pension plans are over funded and that ProvGas' pension plans were 70 to 80 percent funded. She did acknowledge that over time, if there is a significant difference between the NEGas' cash contribution and the FAS 87 expense a greater unfunded liability could result, but she believed ERISA rules would eventually require NEGas to increase its cash contributions.[28]

Mr. Effron testified on behalf of the Division. Under cross-examination by Commission counsel, Mr. Effron recalled that NEGas' pension expense for the merger rate case was based on the FAS 87 expense. Also, Mr. Effron stated that when a company's cash contribution is less than its full FAS 87 expense it increases the probability that there will be an unfunded liability.[29]

After receiving record responses from NEGas, the Commission had an open meeting on May 11, 2006. The Commission adopted NEGas' position on ADIT and rejected the Division's position on the allocation of $352,000 in personnel expense. As a result, the earnings to be returned to ratepayers will be $310,942 above the interim ESM factor in the DAC charge and will be returned to ratepayers starting in November 2006.

COMMISSION FINDINGS

I. NON-ESM PORTION OF THE DAC

The DAC is composed of various factors: LNG, ERC, DSM, LIAP, Weather Normalization, On-System Margins, Reconciliation, and the ESM. With regard to the LNG factor, LNG commodity costs are projected to remain at current levels and, therefore, the current $0.0056 per therm factor is appropriate. For the ERC factor, NEGas proposed to increase the credit to ($0.0019) per therm. Based on the testimony of

[28] Id., pp. 58-59, 62, 68-69, 73-74, 93, 98-101.
[29] Id., pp. 145-147.

NEGas and the investigation of the Division, the ERC costs do not include any costs associated with the Tidewater mercury incident. Mercury regulator costs are not related to the Tidewater mercury incident. Instead, the costs for disposal of mercury regulators is a normal and reasonable expense unlike the costs associated with the Tidewater mercury incident. However, the Commission once again expressly reserves the right to review the prudence and reasonableness of all ERC costs included in the charge. In addition, NEGas proposed a Weather Normalization credit of ($1,602,000) to reflect the colder than normal winter of 2004 to 2005 or a credit of ($0.0045) per therm. This credit was appropriately calculated. As for the non-firm margin factor, NEGas filed a credit factor of ($0.0033) per therm or $1,164,637, which appears accurate. Regarding the reconciliation factor, NEGas proposed a factor of $0.0014 per therm due largely to LNG commodity costs being higher than projected for fiscal year 2005. The undercollection needs to be recovered and so this factor is approved.

II. DSM AND LIAP

In the past, the Commission has noted that it "could reduce the DSM factor if the funds are not being utilized" and indicated that "NEGas' DSM is, in reality, a local management program designed to increase local growth during non-peak periods."[30] In this proceeding, the unused and uncommitted DSM funds balance has continued to grow. It has reached a level of approximately $614,000 which is more than twice the annual appropriation of $300,000. At a time when ratepayers are facing GCR rate increases of approximately 17 percent, having a large DSM fund balance is not appropriate or justifiable. The question is whether these funds should be returned to the ratepayers or reallocated to the LIAP to assist low-income ratepayers.

---

[30] Order No. 17971 (8/23/04), p.16.

At the outset, it should be noted that the Commission has the authority to utilize unused DSM funds for the LIAP. At the hearing, NEGas indicated it would not object to the transfer of unused DSM funds to LIAP.[31] There is no statutory prohibition against the use of these unused DSM funds to be utilized for LIAP. Furthermore, since LIAP is not a PIP program, the requirements of R.I.G.L. §39-2-5(10) are not applicable. In addition, although there is no specific statutory authority for the LIAP to be funded through rates, this program has been in place for a number of years and, like many policies of the Commission, are not specifically set forth in a statute. However, it should be noted that providing assistance to low-income ratepayers for their energy costs is a legitimate public policy objective of this state as demonstrated by R.I.G.L. §39-1-1(d)(7) and 39-2-1.2. Lastly, the LIAP program is part of the DAC charge. The DAC is clearly an adjustment clause which allows the Commission to increase or decrease the amount it recovers through rates for the various programs/components of the DAC. This differs from when an amount set forth in a settlement agreement or included in base rates and there is no adjustment clause in existence.

Returning $613,305 in unused DSM funds to all ratepayers would provide some relief. However, the rate decrease would hardly be noticeable. However, decreasing the DSM factor and increasing the LIAP factor so that LIAP funding increases by $613,305 would have a real beneficial impact on low-income ratepayers. This year ratepayers will experience a 17 percent increase. Increasing LIAP funding by approximately 33 percent will ameliorate the impact of this large rate increase. This one time increase to LIAP is certainly reasonable in light of the large increase in the GCR rate. Furthermore, these unused DSM funds being used for LIAP is consistent with conservation since a portion of

[31] Tr. 10/25/05, p. 77.

LIAP is for weatherization for low-income dwellings. In contrast, a significant portion of DSM funds are currently used to have large commercial entities utilize it to increase natural gas consumption. Thus, the Commission adjusted the components of the DAC factor in order to decrease DSM funds by $613,305 and increase LIAP funding by a commensurate amount.

Lastly, undoubtedly the DSM fund balance will grow again over time. To insure that ratepayers are properly compensated and to avoid giving NEGas cost-free working capital, the Commission adopts the Division's recommendation that a monthly short-term debt interest rate should be accrued on unexpended DSM funds. Since there is working capital allowance in DAC for other programs such as LIAP where NEGas expends funds prior to receiving funds from ratepayers, NEGas does not need to charge interest on funds disbursed prior to collection.

III. ESM

Under Title 39 of the Rhode Island General Laws, the General Assembly has delegated its ratemaking power to this Commission to establish just and reasonable rates. In this case, the Commission must interpret the NEGas Merger Rate Settlement approved by Order No. 17381 in Docket No. 3401. The most pertinent phrase of the NEGas Merger Rate Settlement in calculating earning sharing is that the financial results "will be adjusted to reflect established Commission ratemaking principles."[32] A few differences arose during the proceedings as to how to calculate NEGas' earnings for fiscal year 2005. The Commission will now review each of the Division's proposed adjustments as well as other adjustments that the Commission, on its own initiative, deemed necessary to consider.

[32] Order No. 17381, Settlement Agreement.

A. UNCONTESTED ADJUSTMENTS

There were numerous adjustments to NEGas' ESM calculation which were agreed to by the parties. First, the Division reduced NEGas' operating expenses by $223,319 for legal services performed in relation to the Tidewater mercury incident. This is appropriate, because expenses directly related to the Tidewater mercury incident should not be charged to the ratepayers. Second, the Division trimmed NEGas' operating expenses by approximately $383,000 related to a review of NEGas' health, safety and environmental policies. This is reasonable, because this expenditure should be normalized and the costs spread over three years since the expense was non-recurring. Third, the Division decreased NEGas' operating expenses by $135,000 related to the costs of terminating a supplemental retirement. This is proper, because this expense should also be normalized and the costs spread over three years since it is a non-recurring expense and termination of the plan will produce future savings. Lastly, the Division included NEGas' correction to its statement of the environmental accrual as of June 2004, which diminishes the average depreciation reserve for FY 2005 by $1,101,000 in the rate base. This appears to be a legitimate accounting correction, thus the adjustment can be approved.

B. A&G ALLOCATION

The Division recommended that $352,000 in A&G expense be allocated to the mercury incident and excluded from the ESM calculation. The Commission does not concur with this adjustment. NEGas testified that only a very limited number of individuals at NEGas were involved in the incident and they only spent minimal time on

the incident. Also, NEGas testified that these individuals did not fail to perform their normal work duties.

The expenses directly associated with the Tidewater mercury incident which increase NEGas' costs were excluded. Allocating and excluding a portion of A&G based on speculation would not eliminate inappropriate incremental costs from being charged to ratepayers but merely reduce the normal O&M expense level. This is not justifiable. The Division has had the opportunity to review NEGas' expenses related to the Tidewater mercury incident. It appears that all expenses directly related to the incident were excluded from the ESM calculation.[33] The Commission cannot set rates on mere speculation.[34] Accordingly, the Commission adopts NEGas' position in this matter.

C. ADIT

ADIT has been an issue of dispute in the past. The Division recommended that the balance of ADIT be increased by $309,000, which would equal the subsequent accrual true-up for the last three fiscal years. The Commission will not make the adjustment. NEGas explained that the bonus depreciation tax deduction allowance which caused the higher than projected ADIT expired on December 31, 2004. Since this bonus depreciation has expired, it is unlikely that there will be a significant true-up in ADIT as in prior years. In any case, if the estimate of the ADIT is too low, the higher actual amount of ADIT would be reflected in the next ESM calculation. Thus, the Commission will adopt NEGas' rebuttal position on ADIT.

[33] To the extent the Attorney General's discovery motion regarding the mercury incident was not withdrawn during the proceeding or is moot, it is denied because the Division had sufficient access to the relevant documentation.
[34] R.I. Consumer Council v. Smith 111 R.I. 271, 285 (1973).

D. PENSION FUNDING

In a prior order, the Commission noted that NEGas was not paying "the maximum tax deductible contribution to its pension fund" and that "NEGas must be made aware that it is in the long-term interest of ratepayers to have a properly funded pension fund."[35] NEGas maintains it will make the minimum pension contribution required by ERISA. However, the ESM calculation utilizes a pension expense amount based on FAS 87. Thus, the amount NEGas contributes to its pension fund pursuant to ERISA and the amount it lists as expense pursuant to FAS 87 do differ. For instance, over the last three years since July 1, 2002, when the current ESM went into effect due to the NEGas Merger Rate Settlement, NEGas had a total ESM pension expense of $12,327,566, but NEGas' total pension contribution during the same time period was $9,163,400.[36] The difference in these amounts could be harmful to a pension fund in the long-term. The Commission anticipates that with the acquisition of NEGas by National Grid, the successor to NEGas will follow National Grid/Narragansett Electric's approach to funding its pensions by committing to fund its pension to the maximum tax deductible amount.[37]

To summarize, the Commission will adopt the positions agreed to by parties in the DAC, regarding the ESM calculation, except the Commission will utilize NEGas' approach regarding ADIT and will not allocate any additional portion of A&G expense to the Tidewater mercury incident. As a result, NEGas' earning credit will be approximately $423,222 for fiscal year 2005 or an additional increase of $310,940 above interim rates.

[35] Order No. 18365, p. 21.
[36] NEGas' PUC Data Resp. (4/6/06).
[37] Order No. 18037, Settlement Agreement, p. 16.

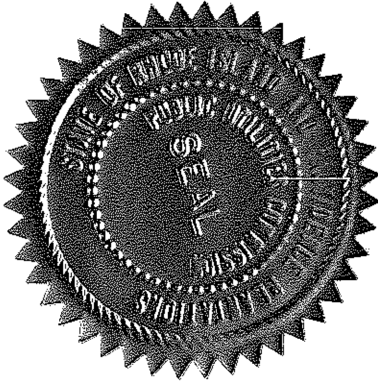
Accordingly, it is

(18780) ORDERED:

1. The system pressure factor of $0.0056 per therm filed on September 1, 2005 by New England Gas Company is approved for effect November 1, 2005.
2. The environmental response cost factor of ($0.0019) per therm filed on August 1, 2005 by New England Gas Company is approved for effect November 1, 2005.
3. The weather normalization factor of ($0.0045) per therm filed on August 1, 2005 by New England Gas Company is approved for effect November 1, 2005.
4. The reconciliation factor of $0.0014 per therm filed on August 1, 2005 by New England Gas is approved for effect November 1, 2005.
5. The on-system margin credit factor of ($0.0033) per therm filed on August 1, 2005 by New England Gas Company is approved for effect November 1, 2005.
6. Interest will accrue on a monthly basis on unused demand-side management funds; the demand side management fund balance will be reduced by $613,305 and by this same amount the low-income assistance program will be increased.
7. The Earnings Sharing Mechanism factor ($0.0003) cents per therm proposed on September 1, 2005 by NEGas is approved on an interim basis for effect November 1, 2005.
8. The Earnings Sharing Mechanism factor will be adjusted to reflect the adjustments made by the Commission within this Report and Order for effect November 1, 2006.
9. New England Gas Company shall comply with all other findings and instructions contained in this Report and Order.

EFFECTIVE NOVEMBER 1, 2005 AT WARWICK, RHODE ISLAND PURSUANT TO OPEN MEETINGS ON OCTOBER 26, 2005 AND MAY 11, 2006. WRITTEN ORDER ISSUED DECEMBER 1, 2006.

PUBLIC UTILITIES COMMISSION



Elia Germani, Chairman

Robert B. Holbrook, Commissioner*

Mary Bray, Commissioner

*Commissioner Holbrook dissents as to Section II of the Commission Findings. His dissent is attached.

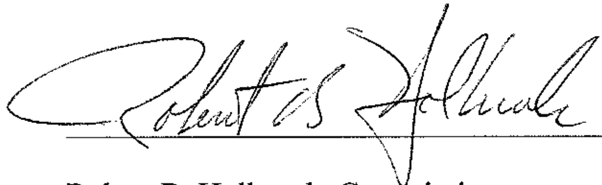
Commissioner Holbrook, dissenting.

I dissent from the portion of the DAC ruling which reallocated unspent DSM program funds of $614,000 to LIAP. These funds were collected from all ratepayers for a particular purpose, namely, demand side management. The only reason the funds, which account for two years of funding and no expenditures, are available is because the Company has not been conducting DSM programs appropriately. Therefore, I can only conclude that ratepayers have been paying approximately $300,000 per year of unnecessary charges and that those funds should be returned to ratepayers through a reduced DAC charge.

It is not sound policy to reallocate funds from one program to another simply because those funds were not utilized in accordance with their intended purpose. There was no evidence on the record that the DSM program and the LIAP program benefit the same class of ratepayers. Therefore, there is no justification for adding to the LIAP program. The purpose of the Commission is to set just and reasonable rates for all ratepayers, without favoring one class of ratepayers. The decision of the majority clearly violates that principle.

Additionally, while it is sound principle to create accounts which are designed to be used for a specific purpose, those funds should be maintained only for that purpose. In the event it may be determined that excess funds have accumulated in the account, the excess should be returned to ratepayers as a credit against future billings and consideration should be given to reducing the future charge to avoid excessive collection.

Furthermore, ratepayers have no assurance that their deposits will be there for withdrawal. A prime example of this in regulation is the Storm Fund, which is set up like an insurance policy for ratepayers' protection in the event of an unexpected and unusually destructive storm. If the funds from this account are utilized for other purposes and there is a crippling storm, ratepayers will be asked to pay again for something toward which they had already been contributing. The transfer of funds from the DSM program to the LIAP program in this instance, although not setting legal precedent, potentially sets a policy precedent which would harm ratepayers well into the future.



Robert B. Holbrook, Commissioner