



State of Rhode Island and Providence Plantations

DEPARTMENT OF ATTORNEY GENERAL

150 South Main Street • Providence, RI 02903

(401) 274-4400

TDD (401) 453-0410

Patrick C. Lynch, Attorney General

April 9, 2008

VIA ELECTRONIC AND REGULAR MAIL

Luly Massaro, Clerk
Public Utilities Commission
89 Jefferson Blvd.
Warwick, RI 02888

**Re: Block Island Power Company – Rate Change
Application Filed On November 9, 2007 –
Commission Docket No. 3900**

Dear Ms. Massaro:

Enclosed for filing in the above-captioned proceeding are an original and nine (9) copies of the prefiled surrebuttal testimony, and schedules supporting the pre-filed surrebuttal testimony, of Mr. David J. Effron on behalf of the Rhode Island Division of Public Utilities and Carriers. Copies of this letter and its enclosure will be filed with you electronically, and provided to all persons on the service list for this docket.

Very truly yours,

William K. Lueker (R.I. Bar # 6334)

Special Assistant Attorney General

Tel. (401) 274-4400, ext. 2299

Fax (401) 222-3016

Encl.

cc: Service List PUC Docket No. 3900

BLOCK ISLAND POWER COMPANY

GENERAL RATE FILING

RIPUC DOCKET NO. 3900

**BEFORE THE
RHODE ISLAND PUBLIC UTILITIES COMMISSION**

**SURREBUTTAL TESTIMONY AND EXHIBITS
OF DAVID J. EFFRON**

ON BEHALF OF THE

**DIVISION OF
PUBLIC UTILITIES AND CARRIERS**

APRIL 9, 2008

1 Q. Please state your name and business address.

2 A. My name is David J. Effron. My business address is 12 Pond Path, North Hampton,
3 New Hampshire, 03862.

4

5 Q. Have you previously submitted testimony in this docket?

6 A. Yes. I submitted direct testimony on February 8, 2008, on behalf of the Division.
7 My qualifications and experience are included with my direct testimony.

8

9 Q. What is the purpose of this surrebuttal testimony?

10 A. The purpose of this surrebuttal testimony is to respond to the rebuttal testimony of
11 BIPCo witness Edge.

12

13 **Officers' Compensation**

14 Q. On page 7, of his rebuttal testimony, Mr. Edge states that he agrees with you that
15 your calculation of management fees is reasonable, but that he can't totally agree
16 with your conclusion. Do you understand his point?

17 A. Not entirely. My conclusion is based on my calculation, and I don't see how they
18 are separable. In addition, I don't agree that the change from the "management fee"
19 structure to a "salary type compensation basis" for the officers is necessarily that
20 important a change. What is relevant is the amount of compensation, whether the
21 compensation is in the form of management fees or salaries. In any event, there is
22 nothing in Mr. Edge's testimony that gives me cause to reconsider my direct
23 testimony on this issue.

1

2 Q. Have you also read the Town's testimony on the management compensation issue?

3 A. Yes. It appears that the Town is proposing not only to reduce the basic cash
4 compensation to the officers, but also to eliminate all of the fringe benefits
5 (principally health insurance) applicable to the Company's officers from the
6 Company's revenue requirement. This represents a substantial change from the
7 method of determining the allowance for officers' compensation from the
8 Company's last rate case. In my direct testimony, I stated that it was my intent to
9 maintain the method adopted by settlement in the last case. I am not changing my
10 position at this time. However, it is my understanding that the Commission has
11 required the sharing of certain employees' fringe benefit costs between ratepayers
12 and investors in other cases. I would recommend that such a sharing of the BIPCo
13 fringe benefits costs be considered in the future.

14

15 **SCR and Engine Maintenance**

16 Q. Mr. Edge believes that you ignored the fact that BIPCo capitalized \$130,000 of
17 SCR and engine maintenance in 2006 in your analysis of that issue (Edge rebuttal,
18 page 9). Is his belief well founded?

19 A. No. In my direct testimony, I proposed an annual allowance of \$200,000, stating
20 this amount is "in line with the average of actual expenditures incurred in fiscal
21 years 2006 and 2007." When I used the term "expenditures", that is exactly what I
22 meant. Based on the response to Division Data Request 1-30, the total expenditure
23 on SCR and engine maintenance in 2006, *including* \$130,945 capitalized, was

1 approximately \$271,000. The total expenditure on SCR and engine maintenance in
2 2007 was approximately \$121,000. Thus, the average of expenditures for this two
3 year period was approximately \$196,000, slightly less than the \$200,000 annual
4 allowance that I proposed in my direct testimony. Had I excluded the capitalized
5 expenditures from my analysis, the average annual expenditures would have been
6 substantially less.

7
8 Q. Are you proposing to modify your recommended annual allowance for SCR and
9 engine maintenance?

10 A. Yes. As I explain later in this testimony, the amortization of the capitalized SCR
11 and engine maintenance should be considered as part of the annual allowance,
12 although that amortization is taking place outside of the reserve accounting
13 specified in Docket No. 3655. I am now recommending an annual expense
14 allowance of \$180,000. This is the amount that should be credited annually to the
15 reserve account. Together with the \$43,103 annual amortization of capitalized
16 expenditures that I am now proposing (surrebuttal on depreciation), the total
17 expense allowance in the Company's revenue requirement is \$223,103. Given the
18 actual expenditures in fiscal years 2006, 2007, and 2008 to date, I believe that this
19 total expense is more than adequate.

20
21 **Lobbying**

22 Q. Does Mr. Edge's testimony that the money spent in the past for lobbying was well
23 spent cause you to reconsider your position on this issue?

1 A. No. Regardless of Mr. Edge's opinion on how well spent the expenses for lobbying
2 have been, as a matter of public policy, expenditures to influence legislation should
3 not be included in the revenue requirements of public utilities. It is my
4 understanding that it has been the consistent practice of the Commission to exclude
5 such expenses from the cost of service.

6

7 **Depreciation**

8 Q. Mr. Edge opposes your adjustment to amortize the balance of capitalized SCR and
9 engine maintenance remaining as of the beginning of the rate year over three years.
10 Do you have a response?

11 A. Yes. Mr. Edge's point that ratepayers have not yet paid any of the \$130,945 that
12 was originally capitalized is well taken. I would also note that if those expenditures
13 had been charged against the reserve, as they normally would have been, the
14 Company would, in effect, receive dollar for dollar recovery of the costs.
15 Therefore, I do not believe that it is unreasonable for the Company to have an
16 opportunity to recover the full amount of the \$130,945 that was originally
17 capitalized, not just the balance remaining at the beginning of the rate year.
18 Therefore, I have modified the pro forma depreciation expense to reflect \$43,103
19 annual amortization of the capitalized maintenance costs.

20 However, I believe that it is also appropriate to treat this annual
21 amortization as a component of the total SCR and engine maintenance expense
22 included in the Company's revenue requirement. When considered in association
23 with the \$180,000 annual provision that I am proposing, the total expense included

1 in the revenue requirement is \$223,103. As I noted above, this is greater than the
2 actual SCR and engine maintenance expenditures in recent years. I would add that
3 it also represents an increase from the annual allowance established in Docket No.
4 3655. Further, to avoid over-recovery of the capitalized costs, I recommend that if
5 the rates established in this case are in effect for more than three years, then BIPCo
6 increase the credits to the reserve account by \$43,103 annually (\$3,592 per month)
7 three years after the date that the rates in the present case become effective.

8
9 Q. Do you have a response to Mr. Edge's proposal to depreciate the new bucket truck
10 over ten years?

11 A. The ten year depreciation life does not seem unreasonable, and I have modified my
12 adjustment to the pro forma test year depreciation expense accordingly.

13
14 **Gross Receipts Tax**

15 Q. Have you modified your calculation of pro forma gross receipts tax?

16 A. Yes. I have now included the miscellaneous revenues in the revenues subject to the
17 gross receipts tax.

18
19 **Federal Income Tax Expense**

20 Q. Have you read Mr. Edge's rebuttal testimony on the subject of federal income
21 taxes?

22 A. Yes I have, and I find it somewhat confusing. He states that he has adopted my
23 method of computing federal income tax expense, but the method on Schedule

1 WEE-15 (Rebuttal) is not my method. I cannot replicate his numbers, and it can be
2 seen that his income tax expense is not consistent with the tax calculated by
3 applying the relevant rates to his taxable income.

4 I do not understand his point on deferred tax expense. The return method
5 calculates the income tax expense for ratemaking purposes. It implicitly includes
6 both current and deferred income taxes, but does not distinguish between those two
7 components of the total tax expense. For example, if the Company records tax
8 accelerated depreciation in excess of book depreciation, the excess will reduce
9 current income tax expense and increase deferred income tax expense, but will have
10 no effect on total income tax expense. The Company's books of account should
11 recognize current income tax and deferred tax expense separately, but as long as the
12 book-tax timing differences are normalized, no such distinction is necessary for the
13 purpose of calculating the income tax expense to be included in the revenue
14 requirement. By adopting the return method, the Commission would implicitly be
15 recognizing any deferred tax expense in the determination of rates, and it is not
16 necessary to "restrict" any associated revenue.

17
18 **Rate Base Adjustments**

19 Q. Mr. Edge states that the surcharge payable related to the IRP and DSM recovery
20 should not be deducted from rate base because the funds are maintained in a
21 restricted account. Do you agree?

22 A. Yes. If the funds are maintained in a restricted account and are not available for
23 general purposes, then I agree that the accrued reserve should not be deducted from

1 rate base. Accordingly, I have eliminated the rate base deduction for the surcharge
2 payable related to the IRP and DSM recovery.

3
4 Q. Mr. Edge agrees that the accrued reserve related to the SCR and engine
5 maintenance should be deducted from the Company's rate base. However, he
6 proposes to use the test year average balance as the rate base deduction. Do you
7 agree with his quantification of the appropriate rate base deduction?

8 A. Given that the balance in the account can fluctuate, I agree that it may not be
9 appropriate to use the balance as of a single point in time. However, if the balance
10 is to be averaged over the course of a year, then the balance should be based on the
11 most recent twelve-month period available, not the average balance for the twelve
12 months ended May 31, 2007. Use of the average balance for the most recent
13 twelve-month period available would reflect the general upward trend in this
14 account and would also be more consistent with the other components of rate base,
15 which reflect rate year, not test year, balances. In the response to Division Data
16 Request 3-3, the Company provided the balances through February 29, 2008. I
17 have used the average balance for the twelve-month period ended February 29,
18 2008, \$257,917, as the rate base deduction for accrued reserve related to the SCR
19 and engine maintenance on my Schedule DJE-7 accompanying this testimony.

20
21 **Property Transfer**

22 Q. Have you read Mr. Edge's rebuttal testimony regarding the appropriate ratemaking
23 treatment on the gain on sale of property recorded in 2006?

1 A. Yes. In his rebuttal testimony, Mr. Edge addresses several issues that he believes
2 are relevant to the determination of appropriate treatment of the gain for ratemaking
3 purposes. I'll respond to those issues as they relate to the Division's position on the
4 treatment of the gain.

5

6 Q. What is the first issue raised by Mr. Edge?

7 A. The first issue raised by Mr. Edge is whether the assets that were sold were utility
8 property. The categorization of the property as utility or non-utility property at the
9 time of the sale is of only limited relevance, at best, to the determination of the
10 appropriate treatment of the gain. Mr. Edge points to a letter from RUS describing
11 the assets as of the time of the sale as being non-utility assets, which, Mr. Edge
12 concludes, means that the ratepayers have no equitable claim to any portion of the
13 gain. In my opinion, the letter from RUS is of no relevance to the appropriate
14 determination of the disposition of the gain for ratemaking purposes.

15 I interpret the reference by RUS to the property as being "non-utility" as
16 meaning that the property was not necessary to provide utility service as of the time
17 of the sale. This is only logical, as if the property were necessary to provide utility
18 service, then its sale would be wholly improper. However, what is relevant for the
19 purpose of addressing the treatment of the gain is whether the assets were treated as
20 utility property over the term of that ownership by BIPCo. There does not appear to
21 be any dispute that BIPCo included the property in rate base over the term of its
22 ownership. The inclusion of the property in rate base means that it must have been
23 utility property during that time; otherwise it did not belong in rate base. As the

1 property was included in rate base, it must be considered to be utility property
2 during the term of its ownership by BIPCo.

3
4 Q. What is the next issue identified by Mr. Edge?

5 A. The next issue is “how ratepayers gain ownership of assets included in rate base.” I
6 believe that the matter of “ownership” of the assets is irrelevant. I am not a legal
7 expert on property rights. However, it is my understanding that once a utility
8 purchases or otherwise acquires ownership of an asset, legal ownership of that asset
9 rests with the utility until the asset is sold or otherwise disposed of, regardless of
10 whether the property is non-depreciable property (such as land) or depreciable
11 property. To the extent that property is depreciated and the original cost of the
12 property is recovered from ratepayers, the investment on which the utility is entitled
13 to earn a return is reduced accordingly; however, there is no conveyance of
14 “ownership” to ratepayers. In determining who has an equitable interest in the gain
15 on the sale of property, the question is not one of formal legal ownership; rather it is
16 a question of who bore the costs related to the property during the term of
17 ownership by the utility and then matching the disposition of any gain to those who
18 were ultimately responsible for the costs.

19
20 Q. Is the next issue raised by Mr. Edge, RUS restrictions on distributions, relevant to
21 the Division position?

22 A. No. I am not recommending any distribution of the proceeds from the sale to
23 customers, shareholders, or anyone else. Therefore, the RUS restrictions on

1 distributions are not relevant. Similarly, the last issue addressed by Mr. Edge, that
2 BIPCo does not presently have the cash to make any such distribution is not
3 relevant to the Division position.

4
5 Q. Mr. Edge then goes on to address the issue of whether there should be a distinction
6 between the treatment of gain on the sale of land and the treatment of gain on the
7 sale of depreciable property. Is the distinction advocated by Mr. Edge appropriate?

8 A. No. His position on this matter appears to be derived from his theory of ownership
9 of utility assets. However, if land is included in rate base and if costs, including
10 carrying costs and property taxes, are borne by ratepayers, then the utility and its
11 investors are insulated from such costs and from the financial and economic risks
12 related to the property and have no equitable claim to the benefits from any sale of
13 that property, regardless of the formal legal ownership of the property. That is,
14 whoever has borne the costs related to the property, whether or not those costs
15 include depreciation, should get the benefit of the gain on the sale of the property.

16
17 Q. Is the next issue raised by Mr. Edge, the treatment of certain structures and
18 improvements on the land that was sold, of any relevance to the Division's
19 position?

20 A. No. As I have explained above, there is no logical basis for distinguishing between
21 the sale of land and the sale of depreciable property in determining how the gain on
22 sale of property should be treated for ratemaking purposes, and I have made no
23 such distinction in my proposed treatment.

1

2 Q. Do you have a response to Mr. Edge's recommendation that if the Commission
3 does determine that the ratepayers should share in the gain, the ratepayers' share
4 should come in the form of a rate base deduction rather than in the form of zero cost
5 equity?

6 A. I cannot dismiss this proposed alternative out of hand. However, in the
7 circumstances of this case, I believe that my recommended approach is more
8 appropriate. There is no question that the property in question has been included in
9 the Company's rate base. It is possible that it may not have been in rate base during
10 the entire term of the Company's ownership. However, the Company's records do
11 not allow an exact determination of when the property was or was not in rate base.
12 As it is my understanding that the utility generally has the burden of proof in these
13 matters, I believe that a reasonable argument could be made that it should be
14 assumed that the property was in rate base for 100% of the Company's term of
15 ownership unless BIPCo could demonstrate otherwise. With this assumption,
16 ratepayers would be entitled to 100% of the gain on the sale of the property.
17 However, I have conservatively assigned only 50% of the gain to ratepayers. Given
18 this conservative assumption, I believe that my treatment of the gain as equity
19 earning a zero percent return is reasonable.

20

21 Q. On pages 28-29, Mr. Edge notes that BIPCo has incurred certain additional
22 expenses related to the sale. Have you incorporated these additional expenses into
23 your calculation of the net gain to be shared with ratepayers?

1 A. Yes. I have included the additional net expenses of \$27,908 identified on Schedule
2 WEE-14b (Rebuttal) in the calculation of the net gain on the sale of property. I
3 would further note that the gross gain in my calculation includes the \$14,400 shown
4 on BIPCo Schedule DGB-2, which Mr. Edge has excluded on his Schedule WEE-
5 14b (Rebuttal).

6

7 **Revenue Requirement**

8 Q. Have you revised your calculation of the Company's revenue deficiency based on
9 your surrebuttal testimony?

10 A. Yes. My Schedule DJE-1S accompanying this testimony incorporates the effect of
11 the updates and modifications addressed above. I have calculated a revenue
12 deficiency of \$181,948 based on this surrebuttal testimony.

13

14 Q. Does this conclude your surrebuttal testimony?

15 A. Yes.

16

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the within prefiled surrebuttal testimony, and schedules relating to the prefiled surrebuttal testimony, of David J. Effron, was served this 9th day of April, 2008, via electronic and first class mail, postage prepaid, upon each person on the official service list in this proceeding.

Robert C. Dillegio