THE NARRAGANSETT ELECTRIC COMPANY
d/b/a NATIONAL GRID

INVESTIGATION AS TO THE PROPRIETY
OF PROPOSED TARIFF CHANGES

RIPUC DOCKET NO. 4065

BEFORE THE
RHODE ISLAND PUBLIC UTILITIES COMMISSION

SURREBUTTAL TESTIMONY
OF BRUCE A. GAY

ON BEHALF OF THE

DIVISION OF
PUBLIC UTILITIES AND CARRIERS

OCTOBER 27, 2009

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I. INTRODUCTION AND PURPOSE OF TESTIMONY

Q. Please state your full name, business address and title.

A. My name is Bruce A. Gay. My business address is 4209 Buck Creek Court, North Charleston, South Carolina 29420. I am President of Monticello Consulting Group, Limited.

Q. Did you previously submit testimony in this proceeding?

A. Yes. I submitted testimony on September 15, 2009

Q. What is the purpose of your testimony?

A. My testimony responds to the rebuttal testimony of Mr. Rudolph L. Wynter, Jr., which was submitted in this proceeding on October 6, 2009. My purpose is to comment on the testimony of Mr. Wynters regarding (1) the linkage of commodity costs and uncollectible accounts, (2) linkage between external factors, such as the unemployment rate, and uncollectible accounts, (3) the appropriate level of collection activity by the Company, including disconnections for non-payment and (4) the appropriate charge-off calculation and ratio.

In addition, I will comment on the rebuttal testimony of Mr. Robert L. O'Brien, which was submitted in this proceeding on October 6, 2009.

I. LINKAGE BETWEEN COMMODITY COSTS AND UNCOLLECTIBLE EXPENSE

Q. Please summarize your understanding of the Company's rebuttal testimony concerning the linkage between commodity costs and uncollectible accounts.

A. In essence, Mr. Wynter disagrees with my testimony and analysis where I demonstrate the primary driver of uncollectible expense over the last several years is related to the Company's management of its customers and delinquent account portfolios. Specifically, Mr. Wynter states that the "Company disagrees that it has not

appropriately managed customer arrearage balances." Further, Mr. Wynter continues to assert that the primary drivers of the Company's uncollectible expense are a result of increases in commodity prices and economic conditions, which are external factors beyond the Company's ability to control.

Q. Do you agree with the Mr. Wynter's rebuttal testimony that the increase in commodity prices and economic conditions are the primary drivers of Company's uncollectible expense?

A. No I do not. As stated in my previous testimony, my analysis shows that the relationship between commodity prices and the Company's uncollectible expense is mixed and inconclusive. Specifically, over the last two and one-half years, the Company's average monthly bills and average charge-off balances for customer accounts did not increase or decrease in lockstep with changes in commodity prices. In fact, in some cases, average monthly bills and charge-off balances moved in opposite directions of changes in commodity prices. While it may be intuitive to believe higher commodity prices will automatically drive up uncollectible expense, there are many other factors such as weather, usage and conservation, which influence the level of average monthly bills and subsequent charge-offs. In any event, the single most important factor driving uncollectible expense is the Company's management of its customers and delinquent accounts.

Mr. Wynter does not dispute the accuracy of the charts and data (Attachments 1, 2 and 3) submitted as part of my testimony on September 15, 2009. In addition, Mr. Wynter does not mention Attachment 3 of my testimony, which provides a more detailed comparison of increases in commodity prices and average monthly bills and charge-off balances since 2007. The charts and data clearly show average monthly bills and average charge-off balances for customer accounts did not move in lockstep with changes in commodity prices. In response to the presentation of the charts included in my testimony, Mr. Wynter argues that I inappropriately limited my "focus to specific

points in time when…there were no Standard Offer price increases and when the average customer bill is at its low point for the year." In an attempt to refute my analysis, Mr. Wynter offers alternative specific points in time in my charts that supposedly show increases in average customer bills during times of price increases. Although it is not clear where Mr. Wynter sees increases in average monthly bills for each instance he selects (i.e., January 2008, July-August 2009 and December-January 2009), the point is that, based on the Company's own data, changes in commodity prices did not automatically increase customers' average monthly bills or subsequent average charge-offs balances.

Q. Do you agree with Mr. Wynter's rebuttal testimony that economic conditions is the primary driver of Company's uncollectible expense?

A. No I do not. As stated in my previous testimony, the current state of the economy and economic situation in Rhode Island certainly are negatively impacting customers and businesses. However, the Company's charge-offs were increasing years before the current economic downturn. In fact, according to the Company's previous testimony, charge-offs have increased each year since 2004. As evidence of the impact of economic conditions on the Company's rate of charge-offs, Mr. Wynter presents a chart illustrating the seasonally adjusted unemployment rate for Rhode Island, noting the August 2009 preliminary unemployment rate of 12.8 percent. However, the chart also shows that the unemployment rate was relatively flat from 2003 to mid-year 2007, a period during which the rate of charge-offs were increasing. The Company offers no explanation for the increase in charge-offs other than commodity prices, the economy and regulations. However, increases in commodity prices, the worsening economic conditions and difficult regulations are exactly why the Company should have aggressively focused on managing its customers and delinquent accounts years earlier. Based on the Company's performance data and testimony, it did not react early enough or sufficiently to control its growing portfolios of delinquent accounts. Mr. Wynter states that "in response to the increased

arrearages and write-off levels influenced by these forces [i.e., regulatory and other external forces], the Company implemented its bad debt mitigation strategy after the first quarter of calendar year 2008. The question is why the Company waited until mid-year 2008 to deploy its debt mitigation strategy. Had the Company implemented many of these strategies several years earlier, it would have been in a better position to control delinquent balances before the impact of the economy and before average balances became unmanageable for many customers and for the Company. The Company effectively ignored the risk associated with millions of dollars worth of very aged account receivables. As a result, the ratepayers of Rhode Island should not be penalized for the Company's lack of performance over the last number of years.

I. DISCONNECTIONS FOR NON-PAYMENT

Q. Please summarize your understanding of the Company's rebuttal testimony concerning its management of delinquent portfolios, including disconnections for non-payment.

A. According to the rebuttal testimony, Mr. Wynter:

1. Disagrees with my testimony and analysis where I quantitatively demonstrate the primary driver of uncollectible expense over the last several years is related to the Company's management of its customers and delinquent account portfolios.
2. States that I ignored that the "Company's disconnection activities have dramatically increased year-over-year, doubling in the period 2004 through 2008."
3. States that my analysis "does not account for the fact that there are factors beyond the Company's control that affect the write-off rate."
4. Suggests that my testimony and analysis ignores "there is a cost imposed on the system to disconnect and restore service" and that "there are also very difficult, customer-specific decisions that the Company must make in evaluating service terminations."

5. Disagrees with my theoretical calculation of the reduction to charge-offs, stating that there is no basis for the conclusion "*the Company would have collected 100 percent of the arrearage balances.*"

Q. Do you agree with Mr. Wynter's rebuttal testimony concerning the Company's management of delinquent portfolios, including disconnections for non-payment?

A. No I do not. As I stated in my previous testimony, the Company did not proactively attempt collection (i.e., outbound calling, notices and disconnections) on tens of thousands of delinquent accounts since 2007, the period of my analysis. Specifically, the Company's collection and disconnection efforts clearly did not keep pace with the aging delinquency and past due balances, especially on non-residential and standard residential customers. Moreover, my previous testimony and analysis specifically accounted for the number of all the Company's collection activities since 2007, including the number of disconnections for non-payment. Specifically, the Company performed limited collection activity on only a small fraction of the total delinquent customer base. As a result, the Company effectively ignored the financial risk associated with the increasing number and aging of delinquent accounts.

Mr. Wynter also states that my analysis does not account for factors that are beyond the Company's ability to control. Although the Company cannot control many external events such as price increases or the economy, it certainly has the ability to mitigate negative impacts by changing policies, tightening credit standards (i.e., securing deposits) and increasing collection activity. Recent economic events provide an illustrative example. In response to a worsening economy, many U.S. financial institutions attempted to mitigate risk of future defaults by tightening credit requirements, reducing or limiting lines of credit and increasing collection activity on delinquent accounts. There is little evidence the Company proactively responded to negative external events, including price increases, increasing rates of charge-offs and a worsening economic environment. In fact, as mentioned, the Company did not

implement its comprehensive debt mitigation strategy until mid-2008. While the Company's debt mitigation strategy is a positive development, there are still a number of industry-proven debt mitigation strategies that are not part the current plan, including securing deposits on certain accounts and assessing late-payment fees.

Mr. Wynter argues that there is a cost imposed on the system to disconnect and restore service. My response is that there is a higher cost imposed on the system (including burdening the ratepayers of Rhode Island) by allowing customers to ignore their bills and allowing past due balances to reach levels that become "toxic" to the system. Although there may well be some customer-specific decisions that must be made in evaluating service disconnections, the question is how did the Company make those types of decisions when it was not proactively reaching out (i.e., performing collection activity) to most its delinquent customers? For example, the Company did not start its outbound calling programs for delinquent accounts until late 2008. In addition, in April 2008, the Company sent disconnection notices to only 22% and 42% of the eligible non-residential and standard residential delinquent accounts, respectively. Only a small fraction of eligible accounts were actually disconnected. It is only when faced with increasing levels of collection activity do many past due customers pay, ask for payment terms or seek assistance. Clearly, the Company did not initiate sufficient collection activity to suggest its service disconnection activity was limited due to customer-specific decisions.

The Company's collection approach to non-residential customers is the most confusing. For example, Mr. Wynter states that "when a small C&I customer is terminated, the revenue stream available to pay the past due arrearages is lost, which is counterproductive unless all other efforts to collect the arrearage amount are exhausted. As a result, the Company uses service terminations as a collection tool, but does not apply this tool if there is a way to work revenue recovery issues out with the customer." Again, it is difficult to understand how the Company was working with

many non-residential customers on customer-specific, collection-type decisions when it was not proactively reaching out (i.e., performing collection activity) to most of its delinquent non-residential customers. In addition, based on the Company's data, there is little evidence that the Company had completed many customer-specific, collection-type decisions based on the low numbers of security deposits or negotiated payment arrangements on delinquent active non-residential accounts. The table below shows the Company's total number of non-residential customers with deposits and payment arrangements in April of 2008:

Narragansett Electric Company--Non-Residential Accounts

Deposits and Payment Arrangements

	Number of Accts. Non-Residential	# Eligible for Disconnection	# Accounts With Deposits	# Accounts with PMT Arrangements
April-08	60,536	8,083	3,629 [1]	255 [2]
Percentage of Total Customers:	100%	13.4%	6.0%	0.4%

Notes: 1. Includes all customers, including past due customers

2. 2009 monthly average. 2008 data not available

Clearly, the Company was not proactively engaged with its delinquent non-residential customers. In any event, most non-residential customers will pay or try to negotiate payment terms at the threat of disconnection. Non-residential customers simply cannot afford to have their business operations shut down due to a service disconnection. It is illogical to assume that past due balances will be lost because of service disconnection of a non-residential customer. In the event that a disconnection forces a non-residential customer to close its business, the arrearage balance was probably already uncollectible. Since most of the Company's charge-offs originate on accounts that close voluntarily, it is incumbent on the Company to assure that past due balances are minimized so that when customers decide to close their accounts or are permanently disconnected the dollars at risk are minimized.

Q. Do you agree with Mr. Wynter's and Mr. O'Brien's testimony disagreeing with your recommended reduction to the Company's charge-offs, stating that (1) there is no basis for the conclusion the Company would have collected 100 percent of the arrearage balances, and that (2) service disconnections would reduce the number of customers thereby reducing the Company's revenue.

A. No I do not. The analysis in my original testimony does not suggest the Company should have "uniformly" disconnected all accounts at a specific period of time based on numbers of days past due. My testimony did specifically state that the Company missed an opportunity to reduce its charge-offs by reducing the *average balance* on the accounts that actually charged-off, either due to disconnection or closing voluntarily. Specifically, assuming the exact same accounts charge-off (business as usual), the Company's charge-offs could have been reduced by lowering the average balance on each account before disconnection. As a result, the Company's strategy should have been to lower the average balances by reducing arrearages earlier, before high balances make it difficult or impossible for the average customer to pay the bill.

In addition, my analysis did not assume all customers would pay 100% of past due balances upon disconnection. My analysis and conclusions were specifically based on the Company's policies and historical data. That is, that most the Company's customers that are disconnected for non-payment restore service in a relatively short period of time (i.e., within hours or a few days).[1] Clearly, disconnected customers do not simply disappear as suggested by Mr. O'Brien. In fact a low percentage of service restoration suggests the Company may have a problem with fraudulent customer behavior, which is preventable. In the case of disconnected non-residential customers, the Company's policy "requires full payment of the arrears to restore electric service that has been turned off for non-payment. This would be for all Commercial

[1] Company's Responses to Division Eighth Set of Data Requests, Divisions Data Request 8-20

Customer Classes." [2] In the case of standard residential customers, the Company's policy on service restorations is as follows:

> After a standard customer is cut-off for non-payment (CONP), a payment plan offer depends upon the pay plan step to which the customer is assigned. For residential standard CONP customers, there is a four-step process. Steps 1 and 2 require zero money down with the remaining balance due over 6 months. If step 3 is reached as a result of a plan default, a minimum down payment of 60% is required and the remaining balance is due over 3 months. If the CONP customer reaches step 4 as a result of a plan default, a minimum down payment of 75% is required with the remainder due over 3 months. If a step 4 customer defaults and is CONP, the Company requires 100% of the balance.[3]

In any event, the Company should have been collecting 100% of the arrearages on non-residential customers restoring service. For those accounts that did not restore service after a disconnection, the Company's strategy should have been to minimize the incremental usage on the risky account before it closed. In addition, had the Company followed its procedures for disconnecting and restoring standard residential customers, a high percentage rate of collection could have been achieved over time. Unfortunately, as mentioned in my original testimony, there is anecdotal evidence from the Division that the Company has not followed the Commission's Termination Rules that require delinquent customers to move to the next higher "payment plan" step after defaulting in a payment agreement. That is, the Company has allowed customers to continuously stay on Step 1 and repeatedly roll their delinquent balances into new payment plans to avoid service disconnections and never be subject to down payment requirements.

[2] Company's Responses to Division Eighth Set of Data Requests, Divisions Data Request 8-12
[3] Company's Responses to Division Eighth Set of Data Requests, Divisions Data Request 8-12

Q. Please summarize your surrebuttal testimony as it relates to Mr. Wynter's and Mr. O'Brien's rebuttal testimony, as well as your original recommendation for a reduction in the Company's charge-off rate.

A. Neither Mr. Wynter or Mr. O'Brien supports their or rebuttal with quantitative facts or data analysis. In contrast, I believe I have quantitatively demonstrated the Company's customer and account receivables management performance over the last several years. The Company had an opportunity to reduce charge-offs by better managing its accounts receivable portfolios and optimizing its collection and disconnection activities in the years before the test period of 2008. As a result, I recommend charge-off percentage of 0.71% be used in establishing the revenue requirements in this proceeding.