STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

Docket No. DE 10-055

Unitil Energy Systems, Inc.
Petition for Approval of Base Rate Increase

DIRECT TESTIMONY

OF

STEVEN E. MULLEN

November 5, 2010

TABLE OF CONTENTS

LIST OF ATTACHMENTS

I. INTRODUCTION AND SUMMARY

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

A. My name is Steven E. Mullen. I am employed by the New Hampshire Public Utilities Commission as the Assistant Director of the Electric Division. My business address is 21 South Fruit Street, Suite 10, Concord, New Hampshire.

Q. Please summarize your educational background and work experience.

A. In 1989, I graduated *magna cum laude* from Plymouth State College with a Bachelor of Science degree in Accounting. I attended the NARUC Annual Regulatory Studies Program at Michigan State University in 1997. In 1999, I attended the Eastern Utility Rate School sponsored by Florida State University. I am a Certified Public Accountant and have obtained numerous continuing education credits in accounting, auditing, tax, finance and utility related courses.

From 1989 through 1996, I was employed as an accountant with Chester C. Raymond, Public Accountant in Manchester, NH. My duties involved preparation of financial statements and tax returns as well as participation in year-end engagements. In 1996, I joined the Commission as a PUC Examiner in the Finance Department. In that capacity I participated in field audits of regulated utilities' books and records in the electric, telecommunications, water, sewer and gas industries. I also performed rate of return analysis, participated in financing dockets and presented oral testimony before the Commission. In 1998, I was promoted to the position of Utility Analyst III and continued to work in all of the regulated industry fields, although the largest part of my time was concentrated on electric and water issues. As part of an internal reorganization of the Commission's Staff in 2001, I became a member of the Electric Division. I was promoted to Utility Analyst IV in 2007 and then Assistant Director of the Electric Division in 2008. Working with the Electric Division Director, I am responsible for the day-to-day management of the Electric Division including decisions on matters of policy. In addition, I evaluate and make recommendations concerning rate, financing, accounting and other general industry filings. I represent Staff in meetings with company officials, outside attorneys, accountants and consultants relative to the Commission's policies, procedures, Uniform System of Accounts, rate case, financing and other industry and regulatory matters.

Q. Have you previously testified before this Commission?

A. Yes. I have testified before the Commission on numerous occasions.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide Staff's recommendation for a distribution service revenue requirement for Unitil Energy Systems, Inc. ("UES" or "Company"). On April 15, 2010, UES filed testimony and schedules requesting a $10,115,716 increase in distribution service revenues based on a test year ending December 31, 2009. As part of this testimony, I will also be providing comments and recommendations regarding UES' proposals to implement certain measures to address the subject of attrition.

Q. Are others presenting testimony in this proceeding on behalf of Staff?

A. Yes. The following witnesses are also providing testimony on behalf of Staff:

- George R. McCluskey discusses recommendations concerning certain rate design and tariff revisions proposed by UES;
- James J. Cunningham, Jr. provides testimony on the issues of depreciation and

amortization as well as UES' costs in the areas of pensions, post-employment benefits other than pensions (PBOPs), 401(k) expenses, and medical and dental costs.

- James Brennan testifies about "smart grid" applications including a discussion of UES' existing applications as well as future plans;
- Dr. John W. Wilson of J.W. Wilson & Associates, Inc. presents recommendations on behalf of Staff for the appropriate capital structure, return on equity and overall cost of capital for UES; and
- Michael D. Cannata, Jr. of The Accion Group provides comments and recommendations regarding reliability of UES' electric distribution system, UES' proposals for a Reliability Enhancement Plan and a Vegetation Management Plan, and a proposed Large Capital Project step adjustment.

Q. What is Staff's recommended increase to UES' distribution service revenues?

A. As shown on Attachment SEM-1, Schedule 1, line 12 Staff recommends a permanent increase to distribution revenues of $5,102,378. This represents an increase of 14.44% as compared to the proformed test year operating revenues of $35,341,154. This revenue requirement is calculated on a total rate base of $127,501,533, as computed on Schedule 2, and provides for an overall rate of return of 7.85%, as detailed on Attachment SEM-1, Schedule 1B and described in the testimony of Dr. Wilson.

Q. Did UES request temporary rates in this proceeding?

A. Yes. In its April 15, 2010 filing, UES requested a $6.7 million temporary increase in distribution revenues. In Order No. 25,124 (June 29, 2010), the Commission approved a settlement agreement whereby UES was allowed to increase its distribution revenues by $5,158,845 on a temporary basis, effective July 1, 2010, subject to the final decision on permanent rates. Taking the prior temporary increase into consideration, Staff is now recommending a small decrease to distribution revenues of $56,467 (SEM-1, Schedule 1, line 9).

Q. In addition to its permanent rate increase request did UES also request step increases?

A. Yes. As described in the testimony of UES witness Mark Collin, UES also requested two step increases. The first would take effect coincident with the proposed May 1, 2011 effective date of permanent rates to reflect additions to rate base as of December 31, 2010 and the costs UES incurred repairing and replacing portions of its electric system as a result of damage caused by the February 2010 wind storm. The second proposed step adjustment would recover the costs associated with two large substation projects to be constructed in Kingston and East Kingston, New Hampshire during 2012. As included in UES' April 15, 2010 filing, the proposed increases to distribution service revenues as a result of the step adjustments are $3,508,800 and $692,945 for the first and second step adjustments, respectively. These items will be discussed in greater detail later in my testimony.

Q. Were any other types of rate mechanisms proposed by UES?

A. Yes. Specifically, UES proposed to establish a Major Storm Reserve Fund, a Reliability Enhancement Plan and a Vegetation Management Plan. My comments and recommendations regarding those proposals will be provided later in my testimony.

Q. In addition to your recommendations regarding UES' proposed distribution revenue increases and implementation of certain rate mechanisms, are you making any additional recommendations?

A. Yes. Staff proposes the implementation of a five-year earnings sharing mechanism.

Q. Please describe how you've organized your testimony.

A. My testimony begins with comments regarding the subject of earnings attrition and UES' proposal to implement a variety of measures – many of which I have already listed – to address attrition. I then discuss the costs incurred by UES in restoring service as a result of the December 2008 ice storm as well as the proposed recovery of those costs. Next, I provide testimony concerning a recommended distribution revenue requirement, with supporting detailed calculations. Finally, I offer a proposal for establishing UES' distribution rates for the next five years.

Q. Do you have any preliminary comments?

A. Yes. I'd like to thank the Commission's Audit Staff for their thorough work in reviewing UES' test year information and December 2008 ice storm data. Many of their findings have been reflected either in schedules updated by UES during the discovery process or in the schedules that are attached to my testimony.

II. ATTRITION AND RELATED PROPOSED MEASURES

Q. How did UES describe the issue of attrition?

A. According to Mr. Collin, since its last distribution rate proceeding was decided in 2006, UES' customer and revenue growth have not kept pace with increases in operating expenses and rate base additions that have been incurred by the Company. As a result, UES states that its earnings have eroded over that time.

Q. Did UES propose the implementation of certain measures to address attrition in its filing?

A. Yes. Those measures were listed on page 10 of Mr. Collin's testimony, and I have reproduced them here for ease of reference:

- The use of year-end test year to measure rate base;
- A proforma adjustment to address the "known and measurable" inflationary increase in other operating expenses for which proforma adjustments are not otherwise made;
- The funding through distribution base rates of a Major Storm Reserve Fund to cover the operating expenses of preparing for and restoring service associated with future qualifying "major" storms;
- A Rate Year Step Adjustment on the effective date of permanent rates to reflect additions to rate base made during the rate year (2010);
- A Large Capital Project Step Adjustment to reflect major additions to rate base that will occur in 2012 when substation projects in Kingston and East Kingston are completed; and
- A long-term rate plan establishing annual step adjustments associated with a Reliability Enhancement Plan ("REP") and a Vegetation Management Plan ("VMP").

Q. Does your testimony address each of these measures?

A. Yes. With the exception of the inflation adjustment, I have incorporated them into my recommendations, albeit with certain modifications and/or limitations.

Q. Do you support UES' use of December 31, 2009 year-end balances for purposes of calculating rate base?

A. For purposes of this proceeding, yes I do. While in the past I have testified in support of the use of a five-quarter average rate base, I have also participated in negotiating settlement agreements that have provided for the use of year-end rate base and/or step adjustments to recognize post test-year capital additions. Given current economic conditions being experienced by UES and recognizing that new rates will not be effective until May 1, 2011, in my opinion it makes sense to allow UES to include its in-service plant additions as of December 31, 2009 in rates going forward rather than use an average of the plant balances over five historical quarters. This is consistent with my position on this issue in the distribution rate proceeding for Public Service Company of New Hampshire that concluded earlier in 2010.[1] However, if, for example, UES were in a position where it was experiencing significant sales growth, my recommendation might be different. In other words, the positions I have taken regarding rate base in this proceeding could vary in future proceedings depending on the specific facts or circumstances of each case.

Q. Please explain how the proposed inflation adjustment would work.

A. UES has proposed to include an inflation adjustment that would be applied to what it terms "residual O&M expense," that is, cost categories for which "it is not feasible to project specific adjustments…that are comparable to adjustments made to other expense categories."[2] UES has further identified "residual O&M expense" as items "such as fuel for UES' fleet of utility vehicles, professional fees such as actuarial, audit and legal services, office supplies, telecommunications expenses, natural gas for heating, cleaning and building maintenance, snow removal and other contractor services."[3]

Q. Has UES proposed an inflation adjustment in the past?

A. Yes. In its most recent distribution rate proceeding, Docket No. DE 05-178, UES proposed the same type of mechanism. UES' reasoning for supporting an inflation adjustment has not changed from that proceeding, nor has my position recommending that the inflation adjustment not be approved.

Q. Please explain why you do not support UES' request for an inflation adjustment.

A. A utility should not be allowed to substitute what amounts to an assumed and estimated

---

[1] Docket No. DE 09-035.
[2] Collin Testimony, p.16 at lines 9-18.
[3] Id.

adjustment for the Commission's traditional "known and measurable" adjustment standard. UES has no provided no support for its assumption that the inflation rate it has calculated using a blend of historical and forecasted inflation rates will apply in the future, or that it will apply to all cost categories proposed for inclusion in the adjustment. UES has failed to make a persuasive case of attrition that is appropriately remedied by the proposed adjustment. Further, the word "residual" is revealing in that it makes clear that the expenses to which the proposed inflation adjustment would apply are simply those O&M expenses for which a known and measurable adjustment has not been proposed.[4] The annual changes in many of the so-called "residual" expenses can be influenced by factors other than inflation. For example, legal expenses can vary significantly from year to year and are more heavily influenced by the actual legal issues that arise than by simple inflationary factors. Natural gas costs can and do vary by season and by year and are significantly influenced by supply and demand and weather conditions.

Q. Do you have further comments on the proposed inflation adjustment?

A. Yes. UES' description of the residual O&M expenses as those for which "it is not feasible to project specific adjustments" is unpersuasive in light of the fact that the residual O&M expenses used by UES to calculate the inflation adjustment totaled just over $7 million, or approximately <u>26 percent</u> of UES' total O&M expenses. In that light, the proposed inflation adjustment can be viewed as a "kitchen sink" type of approach that really is nothing more than a shortcut to making specific known and measureable adjustments. Moreover, approving such an adjustment removes an important responsibility of management; that is, controlling costs.

[4] UES did remove amortizations and fixed leases from the calculation of the adjustment as expenses not subject to inflation. See Collin Schedule RevReq-3-6, page 1 of 2.

i. MAJOR STORM RESERVE FUND

Q. Please briefly describe UES' proposed Major Storm Reserve Fund.

A. UES has proposed a Major Storm Reserve Fund (MSRF) to recover the costs of responding to significant outages on its system, repairing the system and restoring service to its customers. UES has proposed an annual funding level of $650,000. Further details regarding the proposed Major Storm Reserve Fund can be found in Schedule TPM-2 included with the testimony of UES witness Thomas P. Meissner, Jr.[5] as well as in the text of Mr. Meissner's testimony.

Q. Do other New Hampshire electric utilities have similar mechanisms for recovering the costs of major storms?

A. Yes. Both PSNH and Granite State Electric Company (GSEC) have similar mechanisms. In fact, UES' proposal is modeled on GSEC's major storm mechanism.

Q. Are you in favor of UES establishing a Major Storm Reserve Fund?

A. Yes, but I do not agree with UES' proposed $650,000 annual funding level.

Q. How did UES arrive at its proposed $650,000 annual funding level for the MSRF?

A. It is hard to tell. UES has provided no detailed calculations supporting the $650,000 other than using a per customer calculation based on PSNH's major storm reserve funding level as a type of sanity check. Also, although not clearly stated, it appears that while UES does not plan to recover costs associated with the December 2008 ice storm or the February 2010 wind storm, it did take those costs into account in proposing the $650,000 annual funding level for the purpose of recovering costs associated with future major storms.

Q. In your view, should a major storm reserve account serve to insulate a utility from

[5] UES April 15, 2010 filing, Volume 2 of 2, Bates page 233-234.

all potential storm costs, no matter how infrequent or extraordinary those storms may be?

A. No. A major storm reserve account should be established to deal with the more frequent major storms that have a higher probability of occurring on an annual basis. Extraordinary, infrequent storms such as the December 2008 ice storm and the February 2010 wind storm are examples of storms for which a major storm reserve account is not designed. Incorporating such extraordinary costs into the determination of a level of ordinary and necessary operating expenses is contradictory on its face.

Q. In your opinion, does UES' $650,000 calculation, based on a per customer calculation of PSNH's annual funding level, provide a reasonable representation of UES' annual major storm costs?

A. No, for a number of reasons. First, the amount of PSNH's annual funding of its major storm reserve on a per customer basis has no relation whatsoever to UES. UES and PSNH are two utilities with different service territories in terms of size, terrain, urban versus rural characteristics, customer density, etc. – a point UES is quick to make when it comes to the subject of comparing reliability statistics. Second, PSNH's annual funding level was determined through a review of actual costs incurred as a result of major storms over a period of several years. UES, on the other hand, provided only capital costs associated with major storms that occurred in its service territory since 2000, but it did not include those costs in its calculation of the $650,000 proposed annual funding amount. For only one of those storms, the December 2008 ice storm, did UES provide the related operating expenses incurred. Third, the $4,400,000 PSNH annual level of funding used by UES to make its calculation was PSNH's *proposed* level in its recent rate case filing. As part of an approved settlement agreement in that case, the actual annual funding level of PSNH's major storm reserve is $3,500,000. Finally, if any comparison is to be made between PSNH's annual funding and a proposed level for PSNH, it should be based on a factor such as overhead distribution line miles rather than number of customers.

Q. Please explain how you arrived at your recommended annual funding level of $350,000.

A. UES has approximately 1,050 miles of overhead distribution lines as compared to PSNH's approximate 11,000 miles. Therefore, the ratio of UES overhead line miles to PSNH overhead line miles is roughly 9.5%. Applying that percentage to PSNH's current annual funding level of $3,500,000 results in a potential annual funding level for UES of $332,500. For purposes of recommending an annual funding level, I rounded that number up to $350,000.

ii. RATE YEAR STEP ADJUSTMENT

Q. What items has UES proposed be included in what it has called a Rate Year Step Adjustment?

A. UES has requested a step adjustment to recover (a) the revenue requirements associated with plant additions placed into service during calendar year 2010, and (b) the costs of repairing and replacing portions of its electric system due to damage caused during the February 2010 wind storm.

Q. When would this proposed step adjustment be effective?

A. UES has proposed the step adjustment to be effective with service rendered on and after May 1, 2011.

Q. What is your recommendation regarding allowing UES to recover the revenue

requirements of its 2010 plant additions through the proposed step adjustment?

A. I recommend that aspect of the step adjustment be approved. As the rate adjustment would be effective May 1, 2011, the 2010 plant additions would already be providing service to customers. However, before any recovery amounts are approved, UES must be required to submit a filing detailing its 2010 plant additions with sufficient time for the Staff, the Office of Consumer Advocate (OCA) and the Commission to review the costs prior to the May 1, 2011 effective date of the step adjustment.

Q. Has UES proposed a filing date for the submittal of such a report?

A. Yes. As stated on page 45 of Mr. Collin's testimony, UES has proposed to file a schedule detailing actual 2010 additions to rate base and other supporting information no later than March 15, 2011. While that date is acceptable to Staff as a "no later than" date, I suggest that UES make every effort to file the schedule as soon as possible after the end of 2010 to allow the maximum amount of time for review of the information.

Q. What is Staff's recommendation concerning the recovery of UES' costs of restoring power in the wake of the February 2010 wind storm?

A. Staff recognizes that UES incurred a significant amount of costs to restore service as a result of the damage caused by the wind storm and believes that UES should be allowed to begin recovery of those costs as part of this step adjustment.

Q. Has UES provided an estimate of its total February 2010 wind storm costs?

A. Yes. On his Schedule MHC-10, page 2 of 2, Mr. Collin provided a preliminary total of $4,577,281 for UES' wind storm costs.

Q. Have those costs been audited by Staff?

A. As of the filing of this testimony, no they have not. The Audit Staff has had preliminary contact with UES in regard to conducting an audit of the costs, and I expect an audit to take place in December 2010.

Q. What methodology has UES proposed for recovery of its wind storm costs?

A. UES has proposed an accelerated recovery using the sum-of-the-years' digits method, as opposed to straight-line recovery, over a ten-year period. This methodology will be discussed further in Section III of my testimony where I discuss UES' December 2008 ice storm costs.

Q. Are you in favor of using an accelerated methodology for recovery of UES' wind storm costs?

A. I think that an accelerated methodology can be acceptable if it is carefully taken into account as part of the overall revenue requirements and applied appropriately within a utility's overall cost recovery scheme. Given that the overall revenue requirements have yet to be determined in this case and the fact that costs have not yet been reviewed, I will reserve judgment on this issue until more of the details are known.

Q. What are the total costs UES expects to include in the proposed Rate Year Step Adjustment?

A. The total estimated costs as of the filing of UES' testimony, as shown on Mr. Collin's Schedule MHC-10, page 1 of 2, were $3,508,800. As noted, none of the costs have been audited, so the total is preliminary at this point. Therefore, I will not make a recommendation on the total costs at this point other than to state that the methodology for calculating the step adjustment, as shown on MHC-10, page 1 of 2, appears acceptable.

iii. LARGE CAPITAL PROJECT STEP ADJUSTMENT

Q. Please identify the two large capital projects for which UES has proposed recovery through what it has called the Large Capital Project Step Adjustment.

A. The projects are both substation projects, one located in Kingston, New Hampshire and the other in East Kingston, New Hampshire. Both were scheduled to be placed in service during 2012. Detailed review of these projects can be found in the testimony of Michael D. Cannata, Jr.

Q. Have there been any changes to UES' proposal since its testimony was filed?

A. Although there has not been anything officially filed with the Commission, a recent discovery response provided by UES[6] indicates that based on updated load projections as well as other considerations, UES now sees the need for the Kingston substation to be pushed into the future to 2013 or perhaps beyond. UES' response also indicates that "an in service date of June 1, 2012 in unlikely." Thus, it appears that UES has now removed this project from consideration for inclusion in this step adjustment. I note that UES' conclusion about the timing of the need for the project is generally consistent with the conclusion reached by Mr. Cannata as he stated that the need for the Kingston project is "significantly beyond 2012."[7]

Q. What is Staff's position regarding the remaining project for consideration as part of the step adjustment, the East Kingston substation?

A. As stated in Mr. Cannata's testimony, Staff's opinion is that the project is necessary and that the projected 2012 timing of the project is reasonable. Therefore, Staff supports recovery of the revenue requirements associated with that project as part of the proposed

[6] Attachment SEM-2, UES supplemental response to Staff 1-31.
[7] Testimony of Michael D. Cannata, Jr. at 25.

Large Capital Project step adjustment, subject to the same comments as above regarding detailed review of the costs by Staff, the OCA and the Commission.

Q. Is there a proposed effective date for this step adjustment?

A. Other than stating that the project is expected to be placed in service during 2012, UES has not suggested a specific effective date for the step adjustment. The actual date will depend on the actual in-service date of the project.

iv. RELIABILITY ENHANCEMENT PLAN/VEGETATION MANAGEMENT PLAN

Q. Please briefly describe UES' proposals to implement a Reliability Enhancement Plan (REP) and a Vegetation Management Plan (VMP).

A. As described by UES witness Thomas P. Meissner, Jr., the REP will include both capital projects and operations and maintenance expenses targeted to improving the reliability of UES' electric system. The proposed VMP would replace UES' existing vegetation management program based on a consultant's comprehensive review and evaluation of the existing program. According to Mr. Meissner, both the REP and the VMP are intended to provide improved reliability.

Q. Do other New Hampshire electric utilities have either an REP or a VMP?

A. Yes. PSNH and GSEC each have REP and VMP programs in place.

Q. Does Staff support the implementation of an REP and a VMP for UES?

A. Yes, but some of the details will have to be further discussed.

Q. Has Staff performed a detailed inquiry into the specifics of UES' proposed REP and VMP?

A. Yes. Detailed comments concerning the REP and VMP are provided in Mr. Cannata's testimony. Regarding the REP, Mr. Cannata states that he does not disagree with the types of projects UES proposes to undertake and while the proposed funding appears reasonable, he is concerned that UES will be trying to attack too many areas needing improvement all at once. As for the VMP, Mr. Cannata expresses concerns with some of the particulars, including the planned trimming cycles as well as proposed staffing issues. As some of Mr. Cannata's recommendations may actually require additional funding over and above that proposed by UES, one thing that will have to be taken into consideration is the possibility of phasing in some of the programs and/or funding requirements of the REP and VMP.

III. DECEMBER 2008 ICE STORM COSTS

Q. In this proceeding has UES requested recovery of the costs it incurred in restoring power as a result of the December 2008 ice storm?

A. Yes. As shown on Mr. Collin's Schedule RevReq-3-9 in UES' April 15, 2010 filing, UES was originally seeking recovery of $2,410,011, including carrying costs (or return).[8] The Audit Staff conducted a review of UES' ice storm costs and, as a result, certain adjustments were made which led to a revised total of $2,043,881.[9]

Q. Over what period of time has UES requested recovery of the remaining costs?

A. UES is currently requesting recovery of the costs over a ten-year amortization period using an accelerated method of recovery called the sum-of-the-years'-digits. As shown on Mr. Collin's Schedule RevReq-3-9, the requested annual recovery is $553,243 including UES' calculated return.

Q. Have you previously filed testimony in any proceedings where you've supported the use of the sum-of-the-years' digits method for recovery of storm costs?

---

[8] UES does not have insurance coverage for major storm damage, as UES has stated that it would not be cost effective. See Attachment SEM-3, UES response to OCA 1-4.
[9] See Attachment SEM-4, UES response to OCA 3-3.

A. Yes. In Public Service Company of New Hampshire's (PSNH) recent distribution rate proceeding, Docket No. DE 09-035, I proposed the use of the sum of the years' digits method in connection with a five-year earnings sharing mechanism.

Q. What rate of return did UES include in its calculations?

A. During the period December 2008 through December 2009, UES calculated a return on the unamortized balance using an overall cost of capital of 8.70%. Over the ten-year period UES seeks recovery of the costs, it used a rate of 8.83%, consistent with its cost of capital testimony in this proceeding.

Q. Using the rate of return employed by UES, what did UES calculate as the total amount of return to be paid by its customers until UES has recovered its ice storm related costs?

A. UES calculated a total return (after audit) of $83,551 for the period December 2008 through December 2009[10] with an additional $536,687 over the ten-year recovery period.[11] As those returns were calculated using costs of capital that include an equity component, they include a provision for shareholder return (profit).

Q. Do you have any comments regarding those rates of return?

A. Yes. In my opinion, both the 8.70% and 8.83% rates of return are too high, especially as they provide for shareholder returns. Based on a review of UES' monthly short-term debt balances provide in Mr. Collin's Schedule RevReq-6-5, page 2 of 2, in the months during and immediately after the ice storm, UES' short-term debt balances increased significantly. Therefore, it is reasonable to conclude that short-term debt was a primary source of funding for UES' ice-storm related costs. That short-term debt was later refinanced with long-term debt at a rate of 5.24%.

---

[10] Attachment SEM-5, UES response to Audit Issue #13.
[11] Attachment SEM-4, UES response to OCA 3-3, page 2 of 2.

Q. What rate of return do you recommend be applied to UES' ice storm costs?

A. I recommend applying the 5.24% cost rate of UES' recent long-term debt financing to the unamortized balance of UES' December 2008 ice storm costs.

Q. Over what period of time do you recommend UES be allowed to recover its December 2008 ice storm costs?

A. I recommend a ten-year recovery period.

Q. How did you determine that a ten-year recovery period was reasonable?

A. Although I recognize that UES' short-term debt (that was recently refinanced with long-term debt) was also used for purposes other than ice storm costs, my proposed recovery period matches the term of the long-term debt issuance.

Q. What amortization method do you recommend using over the ten-year recovery period?

A. Consistent with UES's proposal, as well as my testimony in the PSNH docket, I recommend that UES be allowed to recover its costs using an accelerated amortization method called sum of the years' digits. I tie this recommendation to my additional recommendation concerning the implementation of a five-year earnings sharing mechanism that is described later in my testimony.

Q. Please explain how the sum of the years' digits method works.

A. Under the sum of the years' digits method, the digits for each of the years of the amortization period are summed. In this case, as I am proposing a ten-year amortization period, the sum of the digits one through ten equals fifty-five. The annual amortization percentage is then calculated by dividing the number of years' amortization remaining by the sum of the years' digits. For example, the year 1 amortization percentage is calculated as follows: 10 years remaining divided by 55 = 18.18%. For year 2, the calculation is 9/55 = 16.36%, and so forth for each of the ten years. I have calculated the annual amortization expense including my proposed return on Attachment SEM-1, Schedule 4.

Q. What impact does applying your recommended rate of return have on UES' total ice storm costs to be recovered?

A. As shown on my Attachment SEM-1, Schedule 3C, using my recommended recovery methodology and rate of return, I have calculated the total December 2008 ice storm costs to be recovered by UES as $2,010,653, a reduction of $33,228 as compared to UES' adjusted total of $2,043,881. As for the additional return to be paid over the ten-year recovery period, my proposal to use a 5.24% rate of return rather than UES' rate of 8.83% results in a decrease in total return of $317,371, from $536,687 to $219,316.

Q. What are some of the characteristics of the ten-year accelerated recovery period?

A. Using the accelerated method of amortization, UES will be able to recover a much higher percentage of its costs in the early years of the recovery period than if I had simply chosen a straight-line amortization. In addition, with the larger recoveries in the early years as compared to straight-line amortization, the nominal amount of return to be paid by UES customers over the years will be reduced.

Q. How will the declining amounts of annual amortization be accounted for in terms of UES' annual revenue requirements?

A. Absent an annual rate change, and all else being equal, UES would be in a position of increasing over-earnings during each succeeding year of the recovery period. However, in recognition of some of UES' arguments regarding earnings attrition it is experiencing (due to lower sales, etc.), I recommend that UES not be required to adjust its distribution rates on an annual basis. Rather, it is my position that the decline in annual amortization expense without a corresponding rate decrease should serve as a way of providing some "headroom" that would provide funds to support the revenue requirements associated with annual capital additions. This will be discussed further in the section of my testimony that deals with attrition.

IV. REVENUE REQUIREMENTS

Q. How are the supporting schedules for your revenue requirements testimony organized?

A. My testimony and schedules follow the same path. That is, my testimony describes the information found on my attached schedules in a natural progression from the first page of the schedules through the last page of the schedules. The schedules used to support Staff's computation of the revenue requirement are all contained in Attachment SEM-1 and are arranged as follows: Schedule 1 shows the actual distribution service revenue requirement calculation. Rate base is derived on Schedule 2, and the income statement is shown on Schedule 3. Each of those three schedules has supporting schedules that set forth recommended adjustments and other information. Those supporting schedules are denoted as Schedules 1A, 1B, 2A, 3A, and 3B. For ease of reference, I have sequentially numbered all my recommended adjustments to rate base, revenues and expenses. Attachment SEM-1 also contains Schedule 3C to support my recommendations regarding UES' December 2008 ice storm costs. Finally, Schedule 3D supports my recommendations with regard to UES' lease expense. Attachments SEM-2 through SEM-9 are copies of discovery responses and other supporting information.

i. COST OF CAPITAL

Q. Please describe the computation of cost of capital shown on Schedule 1B?

A. The schedule uses the same capital structure and cost rates used by Dr. Wilson to determine his recommendation for UES' overall cost of capital. I have included the schedule along with some additional columns to provide further detail regarding the derivation of Staff's recommended capital structure. Support for the cost rates applicable to the various components of the capital structure can be found in Dr. Wilson's testimony.

ii. RATE BASE ADJUSTMENTS

Q. Looking at Attachment SEM-1, Schedule 2, your calculation of rate base, could you please describe how you have arranged that schedule in terms of the various columns that are shown?

A. The first five columns on Schedule 2 duplicate columns (4) through (8) and the amounts shown on UES witness Mark Collin's Schedule RevReq-5 (UES filing, Volume 1 of 2, page 102). The next column shows additional adjustments that I will discuss below. My recommended adjustments to rate base are then applied against UES' adjusted balances to arrive at the final column entitled "Adjusted Rate Base."

Q. What balances did UES use for plant (and other rate base items) for calculating its proposed rate base?

A. UES started with the traditional five-quarter average rate base, then adjusted all balances to December 31, 2009 year-end balances.

Q. Please describe your recommended rate base adjustments.

A. As stated previously, I have numbered my adjustments. Additional detail for each of the adjustments is found on Attachment SEM-1, Schedule 2A. Adjustment #1 recognizes the combined impact of Staff witness James J. Cunningham, Jr.'s recommended reductions to depreciation and amortization expenses. As depreciation and amortization expenses decrease, the offset is a decrease to accumulated depreciation.

Q. Please explain your adjustment to the working capital allowance.

A. Adjustment #2 represents a reduction to the cash working capital allowance due to (a) various adjustments I have made to O&M expenses, and (b) removal of non-distribution related costs from UES' proposed calculation. As the O&M expenses change, the amount of cash working capital will also change.

Q. What is the impact of your recommended adjustments to O&M expenses on the cash working capital allowance?

A. If you compare my total O&M expenses of $14,780,630 to UES' proposed total of $16,118,948, the net change to cash working capital, using a 45-day formula, amounts to an approximate $165,000 decrease to rate base. The remainder of my adjustments to the cash working capital calculation result in another almost $3,400,000 decrease to rate base.

Q. UES' calculation of cash working capital as shown on Mr. Collin's Schedule RevReq-5-3 includes approximately $9.3 million for Contract Release Payments. What are Contract Release Payments?

A. Contract Release Payments are costs paid to Unitil Power Corp. related to certain long-term power contracts that are recovered through UES' Stranded Cost Charge.

Q. If Contract Release Payments are a form of stranded cost, then why are they included in this filing for purposes of calculating cash working capital?

A. UES' Stranded Cost Charge rate component does not currently include a provision for cash working capital, so historically the costs of the CRPs have been included in determining cash working capital in distribution rate proceedings.

Q. Should the cash working capital associated with the CRPs be included in distribution rates?

A. No. Cash working capital for cost categories that have their own rate components – such as stranded costs – should be recovered through those respective rate components.

Q. Did UES include other types of non-distribution costs in its determination of cash working capital?

A. Yes. Specifically, UES included transmission expenses as well as certain administrative costs associated with default service and energy efficiency programs totaling $18,156,559 in its calculation of cash working capital. Similar to stranded costs, the rate components for recovering transmission and default service costs do not currently include a provision for cash working capital for the specific costs included by UES. While I understand that UES calculated cash working capital in a manner consistent with past distribution rate cases, one of the reasons for unbundling rates was to clearly identify the costs associated with different aspects of an electric utility's business. To the extent that working capital associated with other aspects of UES' business is included in distribution rates, distribution rates will be higher than they otherwise should be.

Q. Considering that the rate components for the recovery of stranded costs, transmission costs and default service costs do not address the cash working capital associated with the specific costs you've removed from the

calculation, how do you recommend that UES be able to recover the cash working capital going forward?

A. I recommend that the issue be addressed in the next proceedings pertaining to the Company's Stranded Cost Charge (SCC), External Delivery Charge (EDC) and Default Service Charge (DSC).

Q. What are the potential consequences if UES continues to include non-distribution costs in its calculation of cash working capital to be recovered through distribution rates?

A. If UES continues to recover cash working capital associated with transmission expenses, stranded costs and default service administrative costs through distribution rates, there will be inequities going both ways with respect to UES and its customers. To explain further, assume a five-year period between distribution rate cases. If, over that period, UES' transmission expenses increase (which they are expected to do), UES will be recovering only the cash working capital associated with the lower amount of transmission expenses incurred during the test year. Conversely, UES' Contract Release Payments recovered through the stranded cost charge have already decreased significantly from the 2009 test year level. However, as the distribution rates would not change until five years down the road as part of the next distribution rate case, UES would be recovering cash working capital associated with costs that no longer exist at anywhere near the test year level. As the EDC and SCC are reconciled annually and DS rates are adjusted quarterly, recovering cash working capital through those rate components will provide a more equitable and timely recovery scheme.

Q. Do you have any further recommendations regarding UES' cash working capital?

A. Yes. In this proceeding, UES has used a 45-day formula for purposes of calculating its cash working capital. The 45-day formula is a simplified method of computing cash working capital that is based on revenue lag period of one half of a utility's billing cycle plus 30 days. As UES bills its customers monthly, the lag period under this formula approach is 45 days. While I recognize that the formula approach is allowed pursuant to Puc 1604.07 (t), it is not as accurate as a detailed lead/lag study and, as pointed out by Staff witness George McCluskey in his testimony[12], can result in calculated lag periods that vary significantly from those derived from detailed lead/lag studies. With that in mind, I recommend that in UES' next base rate proceeding, it file a detailed lead/lag study so the validity of the 45-day formula approach for use by UES can be tested.

Q. Please describe your recommended adjustment to accumulated deferred income taxes.

A. That adjustment relates to the adjustments to depreciation expense explained in the testimony of Mr. Cunningham. In summary, as Mr. Cunningham's recommendations resulted in a decrease to book depreciation expense, there is a related increase to deferred income tax expense. As the deferred tax expense increases, the offsetting entry is an increase to the deferred tax liability. Adjustment #3 represents the increase to the deferred tax liability account.

iii. INCOME STATEMENT

Q. Turning to Schedule 3, could you please explain how you've organized the operating income statement and the related supporting schedules?

[12] Testimony of George R. McCluskey at 15.

A. The first three columns on Schedule 3 duplicate columns (4), (5) and (6) and the amounts shown on UES witness Mark Collin's Schedule RevReq-2 (UES filing, Volume 1 of 2, Bates page 74). Revenue and expense adjustments that I am proposing are shown in the "Staff Adjustments" column. The last two columns show the recommended increase in revenues and the related tax effect as computed on SEM-1, Schedule 1. Further detail for the various adjustments can be found on Schedules 3A and 3B. Also, as a result of the audit and the discovery process, UES has agreed to a number of the adjustments. On Schedule 3A, I have included the symbol "#" next to those adjustments with which UES has expressed agreement either as a result of the Staff audit or through the discovery process.

a. REVENUE ADJUSTMENTS

Q. Have you made any adjustments to the test year level of operating revenues?

A. Yes. I have made one adjustment in this area. In adjustment #4, I have decreased UES' other operating revenue by $1,651. This is a minor item that was discovered as part of the Staff audit and properly removes a thirteen month of rental income from the teat year.

b. EXPENSE ADJUSTMENTS

Q. Please explain how you have organized your adjustments to UES' operating expenses.

A. On SEM-1, Schedule 3A, I have grouped the adjustments to operating expenses by the main categories of expenses as shown in the income statement on Schedule 3.

Q. Please describe adjustments #5 and #6, reductions to purchased power and transmission expenses, respectively.

A. In Docket No. DE 01-247, UES' restructuring proceeding, UES' costs were unbundled and new rate components were established for recovery of the various categories of costs. Adjustment #5 removes $181,279 of purchased power costs from the determination of distribution rates. Similarly, adjustment #6 removes $199,457 of transmission-related expenses from distribution revenue requirements. It is Staff's position that it would be more appropriate to recover these costs as part of the next Default Service and External Delivery Charge proceedings, respectively.

Q. What changes are you recommending in the area of distribution expenses?

A. I have three proposed adjustments in this area. The first adjustment, adjustment #7, is derived from the audit and relates to a December 2008 expense accrual that was not reversed in 2009, although it should have been.

In adjustment #8, I have reduced UES' proposed annual funding for a Major Storm Reserve by $300,000 (from $650,000 to $350,000) as described earlier in my testimony.

My final adjustment to distribution expenses, adjustment #9, provides for recovery of the costs incurred by UES in restoring service in the wake of the December 2008 ice storm. A detailed explanation of this adjustment can be found in Section III of my testimony, and the detailed calculations are on Attachment SEM-1, Schedule 3C.

Q. Please describe the adjustment you made to customer accounting expenses.

A. My final adjustment to customer accounting expenses (#10) reduces UES' distribution-related bad debt expense by $97,590. As shown on Schedule 3A, UES' distribution-related bad debt expense was quite variable over the period 2006 through 2009. While the general trend was upward, UES' bad debt expense actually decreased by 35% from

2006 to 2007 and then increased by 205% from 2007 to 2008. From 2008 to 2009, bad debt expense increased by 8%, resulting in a test year amount of $367,959. Other than some general statements about the economic recession, UES has not identified specific reasons for the wide variation in year-to-year bad debt expense of an indication as to whether it expects its bad debt expense to remain at the 2009 level in future years. UES has stated that it has created a new position, Customer Assistance Coordinator, in the Credit and Collections Department and has implemented an outbound dialer service to perform collections-related calls.[13] According to UES, the automated dialer service allows the Credit and Collections staff additional time to follow up on delinquent accounts. Taking all of that into account, I am recommending a normalizing adjustment to UES' bad debt expense. The adjustment I calculated results in a decrease to test year bad debt expense of $97,590.

Q. How did you calculate that adjustment?

A. The details supporting adjustment #10 are found on Schedule 3A. First, a simple average of the bad debt expense for the years 2006 through 2009 resulted in $248,531 of expense. Then, considering the wide fluctuations experienced during the years 2007 and 2008, I removed the outlying balances of those years from the computation. The resulting average of the 2006 and 2009 bad debt expense was $270,369. Considering the upward trend in UES' bad debt expense, I selected the higher of the two results. Comparing the $270,369 to UES' test year amount of $367,959 results in a decrease of $97,590.

Q. Please describe your adjustments to administrative and general expenses.

A. The first adjustment in this area, adjustment #11, removes UES' proposed $159,648 inflation adjustment for the reasons I explained earlier in my testimony.

---

[13] Attachment SEM-6, UES response to Staff 4-56.

Adjustment #12 is a reduction to pension expense of $312,603, consistent with the testimony of Mr. Cunningham.

Q. Do you have any comments regarding UES' lease expenses?

A. Yes. UES' affiliate, Unitil Service Corp. (USC) has a lease agreement with another affiliated company, Unitil Realty Corp. (URC) for the building in Hampton, New Hampshire where the corporate headquarters is located. The total amount of space leased is 46,348 square feet, and the total lease costs for the test year were $1,519,042, of which UES paid (through USC overhead charges) approximately 29%, or $440,500. Of the $440,500 charged to UES in 2009, $112,504 was capitalized and the remaining $327,996 was charged to expense. Included in the lease charges, which are meant to reimburse URC for certain of its ownership and operating costs, is a return on equity of 12% applied against the prior month's ending balance of URC's proprietary capital. The total return component included in the $1,519,042 test year lease costs was $564,364. It is this part of the total lease costs of which I have a concern.

Q. What is your concern with the return on equity charged by URC to USC and, ultimately UES?

A. My concern is not with the existence of the return on equity because a building owner leasing to another entity would typically seek to earn a profit from the rent charged to the lessee. In other words, if UES was renting from a non-affiliated entity, I would expect that a profit margin would be built into the monthly rental charge. Rather, my concern is with the 12% equity return rate. Although supporting documentation for the 12% rate was requested from UES, the only support was the following statement:

> The 12% return on equity was initially specified in the calculation of the lease between Unitil Realty and Unitil Service and is not changed during the term of the long-term lease.[14]

In its response to Technical Session Request No. 16, UES also pointed to a May 1, 1997 Form U-1 filing made with the Securities and Exchange Commission. I have reviewed that document – which included a draft version of the lease – as well as the June 15, 1997 executed lease. Nothing in either of those documents mentions a return on equity of 12%, nor do they include any words stating that the rate of return on equity is "not changed during the term of the long-term lease."

Q. Please further describe your concerns regarding the 12% return on equity.

A. First, I have seen no support regarding the reasonableness of the 12% rate, and UES should be required to prove that such a rate is just and reasonable. Second, when related income taxes are taken into account, the annualized effective rate of return on equity is 19.2%, not 12%.

Q. Have you prepared an exhibit to demonstrate that calculation?

A. Yes. In Attachment SEM-1, Schedule 3D, I have recreated UES's response to Technical Session No. 16 on the left side of the page. The 12% return is calculated in column (b), and the 19.2% return is calculated in column (e). Without supporting documentation concerning the rate of return on equity to be included in the lease, it is difficult for me to support such a level of costs. Looking at this from a customer perspective – given that this is an affiliated transaction – customers are paying the taxes on the same equity return twice: once through the lease charges themselves, and again when UES' lease expense is grossed-up for taxes and included for rate recovery.

Q. With that in mind, what do you recommend?

---

[14] See Attachment SEM-7, UES response to Technical Session No. 16.

A. First, UES should be required to provide documentation and any other support for the 12% rate of return on equity currently included in its lease expense. Second, unless such support is provided, the rate of return on equity should be reduced to a rate comparable with the return on equity to be earned by UES as a result of this proceeding. In that way, at least the return rate used would have recently undergone scrutiny and be supportable.

Q. Have you calculated the impact of such a change to the overall lease expense?

A. Yes. On the right side of Schedule 3D, I have prepared the calculations beginning with a rate of return on equity of 9% (consistent with Dr. Wilson's recommendation for UES) rather than 12%. As shown at the bottom of column (h), the overall impact to UES of using the lower rate would result in a decrease to test year lease expense of $40,916. That reduction is shown on Attachment SEM-1, Schedule 3A as adjustment #13.

Q. Do you have any final comments regarding the lease for the Liberty Lane property?

A. Yes. One of the costs included in the total lease payments is an 8% interest cost. The 8% interest rate is tied to a twenty-year mortgage on the property. Considering that UES was recently able to obtain long-term debt financing at a rate of 5.24% (substantially below the 8% mortgage rate), URC should investigate whether or not it is advantageous to refinance the existing mortgage. Any resulting annual debt savings would then be passed on to USC and, ultimately, UES, through lower lease payments.

Q. Please continue describing your adjustments to administrative and general expenses.

A. Adjustment #14 removes an allocated portion of UES' PUC assessment from distribution rates. The PUC assesses its costs to each utility based on that utility's total New Hampshire operating revenues. Similar to my earlier discussion regarding cash working capital, it is appropriate to allocate portions of the PUC assessment to UES' various unbundled rate components, based on the respective operating revenues applicable to each rate component. In a discovery response[15], UES calculated the non-distribution portion of the PUC assessment at $283,907. Therefore, in adjustment #14 I have removed this amount from UES' distribution revenue requirement.

Adjustment #15 stems from the audit report and provides for a normalization, using a three-year average, of two legal expense sub-accounts that experienced abnormally high balances in 2009 as compared to the prior two years. The result of that adjustment is a recommended reduction of $31,807.

Adjustment #16 removes $5,699 of test year costs associated with the use of UES' vehicles for community service projects. These costs are similar to charitable contributions and, therefore, I have removed them from the test year.

Q. Please describe your remaining adjustments to administrative and general expenses.

A. The remaining adjustments to administrative and general expenses, #17, #18 and #19, all result from the Staff audit. In #17, I have reduced expenses by $6,006 to correct intercompany allocations related to invoices from Calypso Communications as well as to adjust for expense versus deferral treatment of some of the related costs. While UES has expressed general agreement with the comments of the Audit Staff on this issue, UES has only indicated agreement with $3,971 of the adjustment.

[15] Attachment SEM-8, UES response to OCA 2-38.

Adjustment #18 removes $1,549 of costs related to certain energy efficiency-related dockets from administrative and general expenses.

Finally, in adjustment #19, I have removed a total of $118,892 from various administrative and general accounts dealing with bank fees, legal and professional fees and customer communication costs. As UES has agreed to these various normalizations and adjustments, I have grouped them together rather than discuss them individually.

Q. Have you made any adjustments to depreciation expense and amortization expense?

A. Yes. Consistent with the testimony of Mr. Cunningham, I have included an adjustment to reduce the annual depreciation expense by $1,082,794 (adjustment #20). I have also included Mr. Cunningham's recommended reduction of $32,384 (adjustment #21) to amortization expense.

Q. Please describe your adjustments to taxes other than income.

A. Both of the adjustments in this area are a result of the Staff audit and are adjustments to which UES has expressed agreement. Adjustment #22 removes an out-of test year property tax payment from the test year expense total. Adjustment #23 recognizes an increase to property taxes resulting from a correction of property taxes that were improperly capitalized during the test year.

Q. Have you calculated the impacts to income taxes resulting from your various adjustments?

A. Yes. Those calculations are shown on Schedule 3B. Schedule 3B includes both current and deferred tax impacts. For simplicity purposes the amounts are combined and reported on the current federal and state income tax lines on Schedule 3. The overall impact of the various adjustments is an increase to federal and state current and deferred income taxes of $1,094,449.

In addition to the revenue and operating expense adjustments previously described, I have included two other adjustments on this schedule. The first, adjustment #24, is an adjustment to interest expense based on my adjusted rate base and Dr. Wilson's weighted cost of debt (as reproduced on Attachment SEM-1, Schedule 1B).

Q. What is the basis for your adjustment to federal and state taxes related to Demand Side Management (DSM) incentive revenue, adjustment #25?

A. If you refer to Mr. Collin's Schedule RevReq-2, there is a column entitled "Test Year Flow-Through." The purpose of this column was to remove all non-distribution related revenues and expenses from the test year for purposes of calculating a distribution-only test year. At the bottom of this column there is a net amount remaining of $336,774. Included in that amount is $188,489 which represents DSM incentive revenue earned during the test year. While UES appropriately removed that revenue from the distribution-only test year, the related income taxes were not removed. Through adjustment #26 I have negated and, therefore, effectively removed the taxes associated with the DSM incentive revenue from distribution revenue requirements.

Q. Has UES agreed that the taxes related to the DSM incentive revenue should be removed from its filing?

A. Yes. This was also an issue in UES' last distribution rate case. The incentive is a "before tax" incentive. What that means is that while UES is entitled to earn an incentive, it is not permitted to gross-up that number for taxes by including the taxes in its distribution cost of service or otherwise. UES calculated the related taxes at $74,660. However, the combined federal and state income tax rate used in that calculation was 39.61% when it should have used the same 40.53% effective tax rate used elsewhere in its filing. Therefore, the actual income taxes to be removed from the filing are $76,395. By including the DSM incentive revenue in the income tax calculation shown on Schedule 3B, the correct amount of $76,395 is removed from the calculation of distribution revenue requirements.

V. EARNINGS SHARING PROPOSAL

Q. Please summarize the various items that Staff has taken into account with regard to the subject of attrition.

A. As described earlier in my testimony, I have included the December 31, 2009 year-end rate base as well as a May 1, 2011 step increase to recognize 2010 capital additions. In addition, Staff also supports the implementation of a Major Storm Reserve Fund as well as a Reliability Enhancement Plan and a Vegetation Management Plan. Finally, Staff supports a step increase to recover the revenue requirements associated with a substation project planned to be placed in service in East Kingston during 2012.

Q. Will your recommendations regarding cost recovery for the December 2008 ice storm and February 2010 wind storm also help address any attrition experienced by UES in the coming years?

A. Yes, specifically, the use of an accelerated recovery methodology. However, I recommend accelerated recovery of those costs ***only*** in connection with a multi-year earnings sharing mechanism.

Q. Please describe your proposed earnings sharing mechanism.

A. Yes. Staff proposes the establishment of a five-year earnings sharing mechanism, similar to ones that are currently in effect for PSNH and GSEC.

Q. How would such a mechanism work for UES?

A. Using the distribution revenue requirement and return on equity determined in this proceeding as a starting point, UES' distribution rates would be fixed, with very limited exceptions, for a five-year period. During that period, UES would be permitted to earn in excess of its allowed ROE, up to a certain level, with any earnings in excess of that level shared with customers. Periodically, UES would be required to file interim accumulated earnings reports to determine whether any sharing with customers is warranted.

Q. What exactly do you mean when you say that UES' distribution rates would be fixed, with very limited exceptions?

A. Consistent with the GSEC and PSNH rate plans, adjustments to UES' distribution rates would only be permitted in accordance with agreed-upon circumstances, for example, newly-created state or federal regulations. In both the GSEC and PSNH rate plans, these circumstances are referred to as "exogenous events." PSNH and GSEC are also allowed to adjust their distribution rates to recover the revenue requirements associated with REP-related expenditures and/or permitted step increases. UES would be allowed the same types of rate adjustments.

Q. Given that Staff has recommended a certain return on equity in this proceeding, does Staff have a recommended earnings threshold above which UES would be required to share its earnings?

A. Not at this time. Such a recommendation must take into consideration facts and risk factors specific to the individual utility. For instance, in this proceeding I have proposed a cost recovery methodology for UES' December 2008 ice storm costs and, potentially, its February 2010 wind storm costs that allows for "headroom" each year as the annual cost amortization decreases without a corresponding decrease to UES' distribution rates.

For comparison purposes, GSEC may earn up to 11%, or 133 basis points above its allowed ROE of 9.67%, before it is required to share its earnings with customers. In the case of PSNH, it may earn up to 10%, 33 basis points above its allowed ROE, before it shares any excess earnings with customers. PSNH also has a lower earned ROE limit of 7% below which PSNH is allowed the opportunity to seek rate relief.

Q. What are some of the benefits of Staff's proposed earnings sharing mechanism?

A. There are many benefits of the proposed mechanism, not the least of which is that it would reduce the frequency of UES' requests for rate relief. In addition, it provides UES with an incentive to control its operating and capital costs as it would have the opportunity to maintain and retain a higher level of earnings. There are certain protections built in for customers, such as, if UES' earnings exceed the earnings threshold through a combination of increased sales and/or decreased costs, those earnings would be shared with customers. Also, allowing changes to distribution rates for certain exogenous events provides protection for UES and its customers in the event of unforeseen tax law changes, accounting changes, etc. Finally, consistent with my position regarding UES' REP and my recommendation that the targeted nature of UES' test year O&M costs stay intact, any increased UES earnings will not come at the risk of reduced reliability or service quality.

Q. Do you have any other comments regarding the earnings sharing mechanism?

A. Staff offers this mechanism as a proposal to be considered by the parties. If the parties wish to pursue this proposed mechanism, it is still important that the items at issue in this proceeding, including revenue requirements, cost of capital and rate design be addressed before decisions can be made regarding the specific details involved in such a rate plan.

VI. COMMENTS RELATED TO OTHER DOCKETS

Q. Do you have any recommendations related to other dockets that you would like to make at this time?

A. Yes. UES currently files quarterly and annual reports on the status of its pension plan pursuant to Commission orders in Docket No. DE 02-221.[16] Considering that UES has already been through one rate case and is now involved in a second rate case since those orders were issued, UES' pension costs have been subject to detailed review. With that in mind, Staff believes that the reporting requirement stemming from that Commission order could be lifted. However, Staff first recommends that UES file a letter in reference to the pension reporting requirements addressing the issue from which the reporting requirements originated. Specifically, UES should inform the Commission of the status of any remaining additional minimum liability associated with its pension plan obligation. UES should also address the impact of any accounting changes that took place subsequent to the respective Commission orders.

VII. CONCLUSION

Q. What are your concluding comments?

A. My testimony includes what I consider to be a balanced and reasoned approach to a number of issues. Taking into account reliability concerns, UES' significant costs incurred in restoring service as a result of the December 2008 ice storm and the February 2010 wind storm, other major storm costs, UES' current earnings and its proposed revenue requirements, Staff believes it has put forth recommendations that provide for continued reliable electric service as well as an opportunity for UES to achieve

[16] 87 NHPUC 873 (December 31, 2002), Order No. 24,107, Docket No. DE 02-221.

reasonable earnings with limits set to protect customer interests.

Q. Does this conclude your testimony?

A. Yes, it does.