STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

EnergyNorth Natural Gas, Inc.
d/b/a KeySpan Energy Delivery New England

DG 07-050
Indirect Gas Costs

Testimony of Ann E. Leary
Regarding
Transition from Use of Accrued to Billed Revenues

November 1, 2007

Q. Ms. Leary, please state your full name and business address.

A. My name is Ann E. Leary. My business address is 52 Second Avenue, Waltham, Massachusetts 02451.

I. BACKGROUND

Q. Please state your position with KeySpan Energy Delivery New England ("KeySpan" or the "Company").

A. I am the Manager of Rates and Regulatory Affairs for KeySpan Energy Delivery New England.

Q. How long have you been employed by KeySpan or its affiliates and in what capacities?

A. In 1985, I joined the Essex County Gas Company as Staff Engineer. In 1987, I became a planning analyst and later became the Manager of Rates. Following the acquisition of Essex by Eastern Enterprises in 1998, I became Manager of Rates for Boston Gas and then subsequently for KeySpan Energy Delivery New England after Eastern was acquired by KeySpan Corporation. Since the acquisition of EnergyNorth Natural Gas, Inc. by KeySpan Corporation, I have been responsible for these matters for EnergyNorth as well.

Q. What do your responsibilities as Manager of Rates include?

A. As the Manager of Rates, I am responsible for preparing and submitting various regulatory filings with both the New Hampshire Public Utilities Commission and the Massachusetts Department of Telecommunications and Energy on behalf of KeySpan's New England local distribution companies, including Boston Gas Company, Essex Gas, Colonial Gas, and EnergyNorth. This includes Cost of Gas ("COG") filings, Local Distribution Adjustment Charge ("LDAC") filings and reconciliations, energy conservation, performance-based revenue calculations, lost-base revenues, and exogenous cost filings.

Q. Please summarize your educational background.

A. I received a Bachelor of Science in Mechanical Engineering from Cornell University in 1983.

Q. Have you previously testified in regulatory proceedings?

A. I have testified in a number of regulatory proceedings before the Massachusetts Department of Telecommunications and Energy in rate matters, including providing testimony relating to cost allocation studies, rate design, cost of gas adjustment clause proposals, and exogenous cost filings. I have testified before the New Hampshire Public Utilities Commission in numerous cost of gas and other regulatory proceedings.

II. SUMMARY OF ISSUE FOR REHEARING

Q. What is the purpose of your testimony?

A. My testimony addresses one issue that arises from Commission Order No. 24,786 in Docket DG 07-033 regarding Northern Utilities, Inc., namely how to transition from the use of billed revenues to the use of accrued revenues for purposes of calculating the balance in the deferred gas cost reconciliation account on which interest is calculated when determining the cost of gas. A substantially similar issue has arisen in this docket.

Q. What is the Company's concern regarding how any transition from the use of billed revenues to accrued revenues should work?

A. It is not clear from Order No. 24,786 how the Commission expects the transition to be made from the use of billed to accrued revenues for purposes of calculating the gas cost reconciliation balance used in the cost of gas mechanism. The way in which such a transition is made is critical because a change in the beginning balance will directly affect the level of interest that accrues on a going-forward basis. If the beginning balance is wrong, the interest will be incorrect on a permanent basis, and the rates set by the Commission will be confiscatory.

Q. Why would the rates set by the Commission be confiscatory if the beginning balance is incorrect?

A. The gas cost reconciliation balance is like a bank account, which has credits and debits over time. If the initial balance in the account is too low, then even though all deposits and withdrawals (i.e., gas revenues received and gas costs incurred) are correctly reflected after that, the balance itself will remain too low on a permanent basis. As a result, the interest that accrues on the balance will always be too low. In the case of the gas cost reconciliation account, the amount "in the bank" at any particular point in time may be in favor of customers (i.e., there is a net overcollection owed to customers) or it may be favor of the Company (i.e., there is a net undercollection owed to the Company). If the beginning balance in this account is artificially reduced at the outset, any subsequent balance in favor of customers will always be too high (and the corresponding interest that accrues in favor of customers will also be too high) or any balance in favor of the Company will be too low (and the corresponding interest that accrues in favor of the Company will also be too low).

Q. How could the Commission's order lead to an artificial reduction of the beginning gas cost reconciliation balance?

A. It is unclear from the Commission's order exactly how the transition from billed to accrued revenues for purposes of calculating the deferred gas cost reconciliation balance is to be accomplished. However, if not done correctly, the transition could result in gas utilities being required to include 12.5 months of revenue, but only 12 months of gas costs, in its reconciliation account for the period prior to the transition date. The extra half month of revenue would improperly reduce the balance in the deferred gas cost reconciliation account. That incorrect lower balance would then be carried forward on a permanent basis. At this point, my understanding of how the transition is to be accomplished is based primarily on discussions with the Commission staff ("Staff"), although Staff's testimony on October 12, 2007 in this proceeding has further clarified and confirmed that understanding. My understanding is that the Staff in fact expects the gas utilities to implement the transition in the way I have just described.

III. SUMMARY OF GAS COST RECONCILIATION MECHANISM

Q. Please describe how the gas cost reconciliation mechanism works.

A. As the Commission is aware, Northern and KeySpan recover their actual gas costs from customers on a dollar for dollar basis, barring a disallowance by the Commission. Each month the gas utilities true up the variance between their actual gas costs and the amount billed to customers. Although there is a delay between when customers are billed and when the bills are actually paid by customers, the utilities record the amount due from customers as revenue when the bills are rendered to customers, not when they are paid. The Staff and the utilities have referred to revenue booked on this basis as "billed revenues" for shorthand. Under the Commission's order in DG 07-033, gas utilities will need to begin booking these revenues when gas is consumed by customers (i.e., on an accrual basis), not when the bill for that gas usage is generated.

Currently, if the utilities' COG billed revenues exceed their actual gas costs, they refund the overcollection with interest to their customers in the next month by netting the amount of the excess plus the associated interest against the gas costs that are used to set the COG rate. If actual gas costs incurred by the Company exceed COG revenues, the excess, along with interest on this deferred balance, is instead added to the costs used to set the COG rate in the next month, and the amount is collected from customers. Under the Commission's order, this same methodology will continue to be used, but gas utilities will be required to book customer revenues when gas is consumed by customers, rather than when a bill is generated. This will have the effect of accelerating the booking of revenues relative to the current methodology. The Company is not contesting this particular change in the cost of gas mechanism because, as I noted in my prior testimony in this docket, the Company has agreed to accept the Commission's ultimate decision on this issue in DG 07-033.

Q. Is the deferred gas cost reconciliation balance you just described treated the same for both the winter (peak) and summer (off-peak) periods?

A. The same mechanism applies for both the peak and off-peak periods, but the Company maintains two separate gas cost reconciliation subaccounts, referred to as Peak Acct. 175.20 and Off-Peak Account 175.40, because the two periods have separately identifiable costs and revenues. Although these accounts are labeled peak and off-peak, they actually record activity during all twelve months of the year. For example, during the off-peak period (May through October), the

Company books underground storage demand charges to the peak period reconciliation account because these costs relate to providing service during the peak period, rather than the off-peak period.

Because the peak and off-peak accounts are maintained separately, the deferred gas cost balance in each account (whether positive or negative) also accrues interest during all twelve months of the year. Thus, the positive or negative deferred gas cost balance in the peak and off-peak subaccounts at the end of each period continues to accrue interest each month during the rest of the year until the balance and the accrued interest can be charged or credited to customers the following year in the proper period. Obviously, with regard to revenues from amounts billed to customers, each subaccount includes only 6 months of activity, with interest normally being the only revenue item occurring during the other 6 months of the year. On a combined basis, however, the peak and off-peak subaccounts include twelve full months of revenues from customer billings, just as one would expect.

Q. What is the mechanism by which the balance from the peak or off-peak period for the prior year is carried forward?

A. After the conclusion of each season (peak and off-peak), the Company prepares a COG reconciliation filing that it submits to the Commission. This filing shows the balance from the prior period and, therefore, the amount that needs to be carried forward to the next peak or off-peak period, as applicable. This balance continues to accrue interest until it is flowed back to or collected from customers.

As noted above, the balance for the peak and off-peak seasons are maintained in separate subaccounts. When the Company makes its COG rate filing for the next peak or off-peak period, the reconciliation balance from the prior peak or off-peak period (including accrued interest) is added to or subtracted from the costs to be collected from customers.

IV. DESCRIPTION OF MISMATCH CREATED BY STAFF'S PROPOSED TRANSITION METHODOLOGY

Q. Why would a change from using billed revenues to accrued revenues create a mismatch of revenues and gas costs?

A. Based on discussions with Staff, it is the Company's understanding that the Staff believes the Commission's order in DG 07-033 would require the gas utilities to begin using accrued revenues instead of billed revenues in November 2005, and that the change should be accomplish by adjusting the balance in the off-peak reconciliation subaccount as of October 2005. The problem with this approach is that the off-peak subaccount for the period November 2004 through October 2005 would then reflect 6.5 months of COG revenues from customer billings but the costs associated with providing only 6 months of service. This mismatch arises because the Staff is proposing that a half month of November 2005 billings should simply be moved into the off-peak reconciliation subaccount as of October 2005. (The problem occurs only in the off-peak subaccount because the adjustment to accomplish the transition is made on a one-time basis, which in this case is to the balance in the off-peak subaccount. I should also note that, because the adjustment relates to the off-peak subaccount, it is simpler for discussion purposes to focus on the six months of customer billings and associated gas costs that belong in that subaccount, rather than the full twelve months of billings and gas costs that are reflected in the combined peak and off-peak reconciliation account. This does not change the fact that, as I previously described, each subaccount actually has twelve months of entries of one kind or another.)

Q. How is it that such a mismatch would arise under Staff's proposal?

A. As I noted earlier, in maintaining the gas cost reconciliation accounts, each month the Company records one month of COG revenues and one month of gas costs. As I have also discussed, there are two different reconciliation subaccounts, one for the peak period (November through April) and the other for the off-peak period (May through October). Because customers are charged different rates for gas during the peak and off-peak periods, bills that relate to shoulder months (i.e., billing cycles ending in November or May that include days from both the peak and off-peak periods) are prorated, so that customers are billed at the proper rate depending on the day on which gas was used. For example, consumption shown on a customer's November bill is allocated between the months of October and November based on degree days and the number of days in the billing cycle that occur in each of those months. Consumption attributed to October is billed at the off-peak rate, and consumption attributed to November is billed at the peak rate. Although the Company assigns a portion of the COG revenues to the off-peak period reconciliation account and a portion to the peak period reconciliation account, in total the Company books only one month of COG revenue for the entire month of November. The same type of proration/allocation occurs with regard to bills issued in May because they reflect usage in both April and May. (April is in the peak period, while May is in the off-peak period.)

The problem with Staff's position is that, to accomplish the transition from billed to accrued revenues, Staff would have the gas utilities book to the off-peak deferred gas cost reconciliation account as of October 2005 those revenues that were billed in November 2005 that are attributable to gas used by customers in October 2005. While Staff's position may appear logical at first blush, it fails to take into account that the off-peak account for the year November 2004 through October 2005 already includes six months of revenues from COG billings to customers. By allocating the November 2005 COG billings back to October 2005 in addition to the revenues already booked, the off-peak COG revenues for the year November 2004 through October 2005 will include an extra half month of customer billings/revenues (i.e., 6.5 months of billed revenues) At the same time, the costs associated with providing only 6 months of service are included.

Q. How is it that the off-peak reconciliation account for the period November 2004 through October 2005 already includes six month of revenues from customer billings?

A. The mismatch occurs because, for the twelve month period November 2004 through October 2005, the off-peak account includes the half month of revenue that was billed in November 2004 but that related to gas used by customers in

October 2004. In addition, it includes a half month of revenue for gas that was billed in May 2005 since half of May 2005's billings are booked to the peak period account because they relate to April 2005 usage. In addition to these two half months of revenues, the account includes the revenues from the five months of billings for June through October 2005. This totals six months of revenues from customer billings. If the additional half month of billings from November 2005 are then added, the result would be 6.5 months of billed revenues. At the same time, there is no similar inclusion of an extra half month of gas costs because gas costs have always been booked on an accrual basis. The result would be a mismatch of revenues and costs, with the excess revenues artificially reducing the balance in the deferred gas cost balance for the period.

Q. Your testimony appears to indicate that the Company already attributes about half of its November COG revenues to October. If that's the case, why would the Staff's approach create a problem?

A. Even though half of November's billings are allocated to the off-peak subaccount, they are still <u>booked</u> to the account in the month of November. They are not pushed back to the month of October. As I mentioned earlier, the peak and off-peak subaccounts each have twelve months of activity. The Staff's approach cuts off the off-peak subaccount as of October and moves November 2005 revenues to October 2005. As I noted above, because the period November 2004 to October 2005 already includes six months of billed revenues and the associated six months of gas costs, Staff's proposal incorrectly results in a mismatch by adding an additional half month of revenues without adding any offsetting costs.

Q. What would be the financial harm to the Company arising from this methodological error?

A. Implementing the transition in the manner proposed by Staff would reduce the November 2005 beginning balance of the off-peak reconciliation account by $4.461 million because of the inclusion of the extra half month of revenue from the prior year's off-peak reconciliation account. Such an error would result in a $471,230 reduction in interest expense in the first year alone. (Schedule AEL-1 sets forth the basis for this calculation.) Even though the gas costs and COG revenues booked to the account would match on a going-forward basis, the reduction in the beginning balance would result in an ongoing loss of interest that would recur perpetually on a going-forward basis. The annual impact of this error in the future cannot be calculated precisely on a prospective basis, but it will be substantial.

V. KEYSPAN'S PROPOSAL TO TRANSITION TO THE USE OF ACCRUED REVENUES WITHOUT A CONFISCATORY IMPACT; CONCLUSION

Q. How does the Company believe the transition from the use of billed to accrued COG revenues should be accomplished for purposes of calculating the deferred gas cost reconciliation balance?

A. The Company believes the best way to address the transition issue would be to establish a special transition account to addresses the extra half month of revenues. The Company could incorporate the ending balance for the proposed peak transition account in its next COG filing to realign the balances in its reconciliation accounts. However, as long as the total revenues (the sum of accrued revenues for both the peak and off-peak reconciliation subaccounts) reflects only one month of revenues and the beginning balances for November 2005 for both the peak and off-peak reconciliation accounts (175.20 and 175.40) do not change and agree with the amount filed by KeySpan in DG 06-121 for KeySpan, the Company would be indifferent to the exact methodology used to transition from billed to accrued COG revenues. The Company would be willing to work with the Staff to resolve this issue. The Staff's current interpretation of Commission Order 24,786, however, would be confiscatory and has no apparent basis in traditional ratemaking principles.

Q. Under the methodology proposed by the Company, does the interest associated with the peak and off-peak reconciliation account balances change

as compared to the original interest amounts previously submitted in its COG filings?

A. Yes, the interest for the period November 2005 through October 2006 would be reduced by $119,302 as a result of the switch from billed to accrued revenues ordered by the Commission, but the confiscatory impact of the transition would have been eliminated (see Schedule AEL-1).

Q. Does that conclude your testimony?

A. Yes, that concludes my testimony at this time.

KeySpan Energy- Energy North

Acct. 175.20+175.40 Deferred Gas Cost for Nov 05-Oct 06

	Billed Revenue	Staff's Proposal Acrued Rev	Company's Proposal Accrued Rev	Staff vs. Billed	KeySpan vs Billed
Acct. 175.20					
Beginning Balance	$4,152,233	$4,152,233	$4,152,233	$0	$0
Gas Costs	$96,926,685	$96,926,685	$96,926,685	$0	$0
Billed Revenues	($102,115,491)	($102,115,491)	($97,650,910)	$0	$4,464,581
Ending Balance w/o Interest	($1,036,573)	($1,036,573)	$3,428,008	($0)	$4,464,581
Interest Applied	$348,216	($16,577)	$319,210	($364,793)	($29,006)
Ending Balance with Interest	($688,357)	($1,053,150)	$3,747,218	($364,793)	$4,435,575
Acct. 175.40					
Beginning Balance	$5,724,337	$1,262,972	$5,724,337	($4,461,365)	$0
Gas Costs	$20,648,879	$20,648,879	$20,648,879	$0	$0
Billed Revenues	($22,720,852)	($22,299,428)	($26,760,793)	$421,424	($4,039,941)
Ending Balance w/o Interest	$3,652,365	($387,576)	($387,576)	($4,039,941)	($4,039,941)
Interest Applied	$135,465	$32,392	$45,170	($103,073)	($90,295)
Ending Balance with Interest	$3,787,830	($355,184)	($342,406)	($4,143,014)	($4,130,236)
Acct. 175.20+175.40					
Beginning Balance	$9,876,571	$5,372,167	$9,876,571	($4,504,404)	$0
Gas Costs	$117,575,564	$117,575,564	$117,575,564	$0	$0
Billed Revenues	($124,836,343)	($124,414,919)	($124,411,703)	$421,424	$424,640
Ending Balance w/o Interest	$2,615,792	($1,467,188)	$3,040,432	($4,082,980)	$424,640
Interest Applied	$483,683	$12,453	$364,381	($471,230)	($119,302)
Ending Balance with Interest	$3,099,475	($1,454,735)	$3,404,813	($4,554,210)	$305,338

Billed Revenue Period	Mid Oct 05- Mid Oct 06	Mid Oct 05- End Oct 05	Nov 05 - Oct 05
Length of period- Months	12	12.5	12.5