November 8, 2004

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

Re: NEGAS Docket 3548, Distribution Adjustment Clause.

Dear Luly,

Enclosed for filing are ten copies of the surrebuttal testimony of David Effron on behalf of the Division of Public Utilities in the above-referenced proceeding.

Very truly yours,

Stephen Scialabba
Chief Accountant

cc: service list

NEW ENGLAND GAS COMPANY

DISTRIBUTION ADJUSTMENT CLAUSE FILING

RIPUC DOCKET NO. 3548

BEFORE THE
RHODE ISLAND PUBLIC UTILITIES COMMISSION

SURREBUTTAL TESTIMONY AND EXHIBITS
OF DAVID J. EFFRON

ON BEHALF OF THE

DIVISION OF
PUBLIC UTILITIES AND CARRIERS

NOVEMBER 8, 2004

Q. Please state your name.

A. My name is David J. Effron.

Q. Have you previously submitted testimony in this docket?

A. Yes. I submitted direct testimony on October 20, 2004. My qualifications, background, and experience are included with my direct testimony.

Q. What is the purpose of this surrebuttal testimony?

A. First, I am responding to the Rebuttal Testimony of Robert J. Riccitelli dated November 1, 2002. Second, I am updating the calculation of over-earnings to incorporate responses to information requests received from the Company after my direct testimony was submitted.

Q. Mr. Riccitelli claims that if your proposed treatment of prepaid PUC assessment were adopted by the Commission, the timing difference "would, in essence, be double counted." Is there any merit to his claim?

A. No. The PUC assessment is not included in the leads and lags that make up the 12.39 day lag reflected on Attachment RJR-1, Page 6. Therefore, reflecting the actual payment pattern for the PUC assessment in the calculation of the average balance of prepayments to be included in rate base would not result in any double counting.

Q. Does the assertion by Mr. Riccitelli that "there is no basis in generally accepted accounting principles to establish a 'negative' prepayment" have any substantive merit?

A. None whatsoever. This is strictly a matter of semantics. The PUC assessment is accrued over the course of the year. If the payment of this assessment takes place after the mid-point of the year (which Mr. Riccitelli does not dispute) then it is paid on average in arrears, not in advance. Whether this is deemed to be an accrual to be offset against the other prepayments or a "negative prepayment" is irrelevant. If this assessment is paid, on average, after it is included in operating expenses, then that payment pattern should be recognized in calculating the net prepayment balance to be included in rate base. If the assessment is paid in advance, then it increases the net balance of prepayments; if it is paid in arrears, then it decreases the net balance of prepayments. It would be inappropriate to increase rate base for a prepayment balance that does not exist.

Q. Mr. Riccitelli opposes your adjustment to accumulated deferred income taxes ("ADIT") because it would "have the Company basing its ESM calculations on amounts that are different from the ADIT numbers reported in its financial statements and accounting records." Do you have a response?

A. Yes. If the ADIT numbers reported in the Company's financial statements and accounting records do not accurately represent ADIT balances on an accrual basis, then the balances on the financial statements should be adjusted for the purpose of determining the Company's rate base. The book-tax timing differences that give rise to ADIT accrue over the course of the year, not at a point in time at the end of the year. Similarly, the source of funds provided by deferred taxes is realized over the course of the year, not suddenly at the end of the year. The fact that the Company does not recognize the increase in ADIT on its books of account until the end of the year does not change this reality.

Q. Do you have a response to Mr. Riccitelli's contention that your method of calculating the average balance of ADIT "is an inappropriate modification to the Company's established accounting practices as adopted and applied by the Commission in prior proceedings"?

A. Yes. I would suggest that he read the Commission's order of August 23, 2004 in this docket again. In that order the Commission found that:

> Because NEGas is not a separate corporate entity, it is difficult and complicated to calculate the ADIT for Rhode Island operations. Accordingly, the Commission encourages NEGas and the Division to devise an ADIT methodology for NEGas.

In effect, the Commission has not previously adopted any particular method of calculating the New England Gas Company's average ADIT balance for the purpose of the ESM. A method that does not record the accrual of ADIT until the end of the fiscal year is not appropriate and should not be approved. The balance of ADIT reflected in the computation of rate base should reflect the appropriate accrual of ADIT over the course of the year.

Q. Mr. Riccitelli also opposes your adjustment to cash working capital. Could you elaborate on your reasons for proposing to change the Company's method of calculating its cash working capital allowance?

A. As I stated in my direct testimony: in response to Division Information Request 2-13, the Company noted that the method of calculating the average balance of ADIT is consistent with the cash working capital calculation. I felt that in fairness to the Company, if I were proposing to change the method of calculating the average balance of ADIT to reflect the average balance over the course of the year, then the method of calculating the cash working capital allowance in rate base should also be modified to reflect the actual cash working capital over the course of the year, even though this modification resulted in an increase to the Company's rate base.

Mr. Riccitelli does not dispute my testimony that the determination of cash working capital for the twelve months ended June 30, 2004 on Attachment RJR-1, Page 6 reflects the cash working capital requirement over the course of Fiscal Year 2004, based on the actual expenses incurred over the course of that year. Rather, he makes alleges that my method of calculating cash working capital is inconsistent with the methodology approved by the Commission in Docket No. 2286. In my review of the Commission order in Docket No. 2286, I could find no reference to the use if a five-quarter average for the purpose of calculating cash working capital, and in my experience it has not been the practice of the Commission base the cash working capital allowance included in rate base on a five-quarter average when establishing rates.

Q. Is Mr. Riccitelli's testimony that you "simply used the working capital at June 30, 2004" accurate?

A. No. The balance that NEG shows as being the working capital "at" June 30, 2004 is actually the cash working capital requirement for the twelve months ended June 30, 2004, based on the expenses actually incurred over that time period. That is exactly the point of my testimony.

Q. Mr. Riccitelli states that your proposal to deduct contributions in aid of construction ("CIAC") from rate base represents "a significant deviation from the Commission's established ratemaking principles." Do you believe this characterization to be accurate?

A. No. It is my understanding that it is the Commission's practice to deduct non-investor supplied funds from rate base. Except for noting a lag between when customers are billed for CIAC and when the Company actually gets the funds (the effect of which he does not quantify), Mr. Riccitelli does not appear to dispute the description of CIAC as non-investor supplied funds. As such, it is appropriate to deduct CIAC from rate base.

Q. What of the statement by Mr. Riccitelli that you did not develop your adjustment for CIAC based on a five-quarter average?

A. Mr. Riccitelli is correct. In fact, in my testimony I explicitly stated that I was using the year end balance as a place holder until the Company supplied the five-quarter average of CIAC. Now that the Company has supplied the five-quarter average balance of CIAC, I have modified my proposed adjustment accordingly (Schedule DJE-1S, Page 4).

Q. Mr. Riccitelli describes a new adjustment to expenses on page 13 of his rebuttal testimony. Have you incorporated this new adjustment into your calculation of operating income?

A. No. This new adjustment apparently relates to an item addressed in the direct testimony of Division Witness Oliver, filed on October 8, 2004. Thus, the Company has known of this alleged error since at least that time but chose not to address it until the filing of its rebuttal testimony on November 1.

Originally, the Company sought to include the $660,242 to which Mr. Riccitelli refers on page 13, line 7 of his rebuttal testimony in the computation of the Environmental Response Cost ("ERC") factor of the DAC. On page 16 of his direct testimony, Mr. Oliver stated that this $660,242 was "neither a newly incurred environmental cost nor a cost for which NEG requires further compensation." As far as I know, NEG has not disputed Mr. Oliver's testimony on this matter. However, it appears that the Company is, in effect, now attempting to achieve "further compensation" for this item through the ESM by treating at least a portion of the $660,242 as an adjustment to actual expenses recorded in the twelve months ended June 30, 2004. The testimony presented by Mr. Riccitelli does not explain why it should be included in the ESM calculation if it is not "a cost for which NEG requires further compensation." Therefore, I have not reflected this new adjustment to expenses in my calculation of operating income.

Q. Have you re-calculated the excess revenue based on the revisions in this surrebuttal testimony?

A. Yes, I have calculated excess revenue of $542,000, including the incremental excess revenue from Fiscal Year 2003 (Schedule DJE-1S).

Q. Have you also re-calculated the ESM Factor to be included in the DAC based on this level of excess earnings?

A. Yes. Based on sales of 355,694,000 therms, the ESM Factor included in the DAC would be $0.0015 per therm (Schedule DJE-1S). This is the same ESM factor that I calculated in my direct testimony.

Q. Does this conclude your surrebuttal testimony?

A. Yes.

NEW ENGLAND GAS COMPANY
CALCULATION OF EARNINGS SHARING
($000)

1	Net Income Available for Common Equity	$ 12,374
2	Common Equity Supporting Rate Base	104,878
3	Earned Return on Common Equity	11.80%
4	Benchmark Return on Common Equity	11.25%
5	Return on Equity above Benchmark	0.55%
6	Earnings above Benchmark	576
7	Company Share of Earnings above Benchmark - 50/50 Sharing	288
8	Company Share of Earnings above Benchmark - 75/25 Sharing	-
9	Ratepayer Share of Earnings above Benchmark	288
10	Revenue to be Refunded	$ 443
11	FY03 Incremental Earnings Credited to DAC	99
12	Total Earnings Credited to DAC	542
13	Firm Throughput (000 Therms)	355,694
14	Earnings Sharing Factor ($/therm)	$ 0.0015

Line Notes

1	Net Income Available for Common Equity		DJE-2S, Page 1
2	Rate Base	$240,545	DJE-2S, Page 3
	Common Equity Ratio	43.60%	DJE-2S, Page 4
	Common Equity Supporting Rate Base	$ 104,878	
3	Line 1 / Line 2		
4	Per Settlement		
5	Line 3 - Line 4		
6	Line 5 * Line 2		
7	Line 5 (up to 1.00%) * Line 2 / 2, not Less than Zero		
8	((Line 5 - 1.00%)*Line 2)/4, not Less than Zero		
9	Line 6 - Line 7 - Line 8		
10	Line 9 /.65 (1- Tax Rate)		
11	Attachment PCC-8, RJR-3, Page 2	76+0.75*31	
12	Line 10 + Line 11		
13	Attachment PCC-8		
14	Line 12 / Line 13		

NEW ENGLAND GAS COMPANY
RESULTS OF OPERATIONS
YEAR ENDED JUNE 30, 2004
($000)

	(1) Company Position	Adjustments		Division Position
Revenue	$ 381,468	$ 162	(2)	$ 381,630
Operation and Maintenance Expense	312,303			312,303
Depreciation and Amortization	19,730			19,730
Other Taxes	20,943			20,943
Income Taxes	6,835	72	(2)	6,907
Operating Expenses	359,811	72		359,883
Operating Income	21,657	90		21,747
Interest on Short-Term Debt	429	(1)	(3)	428
Interest on Long-Term Debt	8,609	(24)	(3)	8,585
Other Interest	153	(20)	(2)	133
AFUDC	(228)	-		(228)
Total Interest Expense	8,963	(45)		8,918
Net Income	12,694	90		12,828
Preferred Dividends	455	(1)	(3)	454
Net Income for Common Equity	$ 12,239	$ 135		$ 12,374

Sources:

(1)	Attachment RJR-1, Page 2			
(2)	Schedule DJE-2S, Page 2			
(3)	Rate Base		$240,545	DJE-2S, Page 3
	Interest on Short-Term Debt	0.18%	428	DJE-2S, Page 5
	Interest on Long-Term Debt	3.57%	8,585	DJE-2S, Page 5
	Preferred Dividends	0.19%	454	DJE-2S, Page 5

NEW ENGLAND GAS COMPANY
DIVISION ADJUSTMENTS TO INCOME
YEAR ENDED JUNE 30, 2004
($000)

Revenue:

Gain on Sale of Utility Property	(1)	162

Interest Expense:

Interest on Conservation Loan Program	(2)	(20)

Income Taxes:

Revenue	(3)	381,630
Operating Expenses	(3)	352,976
Interest	(3)	8,918
Taxable Income		19,736
Income Tax Expense	35%	6,907

Sources:
(1) Response to DIV 2-14
(2) Response to DIV 2-09
(3) Schedule DJE-2S, Page 1

NEW ENGLAND GAS COMPANY
RATE BASE
YEAR ENDED JUNE 30, 2004
($000)

	(1) Company Position	Adjustments		Division Position
Utility Plant in Service	$483,606			$483,606
Less- Reserve for Depreciation	(221,101)			(221,101)
Net Plant	$262,505			$262,505
Add:				
Materials & Supplies	1,723			1,723
Prepaid Expenses	1,027	(133)	(2)	894
Deferred Debits	2,700			2,700
Gas Inventories	-			-
Cash Working Capital	9,851	1,255		11,106
Deduct:				
Accumulated Deferred FIT	(31,252)	(1,019)	(2)	(32,271)
Accumulated Deferred ITC	(1,747)			(1,747)
Contributions in Aid of Construction	-	(759)	(2)	(759)
Customer Deposits	(2,775)			(2,775)
Injury and Damages Reserve	(832)	-		(832)
Rate Base	$241,200	($655)		$240,545

Source:
(1) Attachment RJR-1, Page 5
(2) Schedule DJE-2S, Page 4

NEW ENGLAND GAS COMPANY
RATE BASE ADJUSTMENTS
YEAR ENDED JUNE 30, 2004
($000)

Prepaid Assessment			
Balance	Jun-03		-
	Sep-03	(1)	(221)
	Dec-03	(1)	(441)
	Mar-04	(2)	253
	Jun-04		-
	Average		(82)
	Average per Company		51
	Adjustment to Company Position		(133)
Accumulated Deferred FIT			
Balance	Jun-03	(3)	30,792
	Sep-03	(4)	31,531
	Dec-03	(4)	32,271
	Mar-04	(4)	33,010
	Jun-04	(4)	33,749
	Average		32,271
Contributions in Aid of Construction			
Balance	Jun-03	(5)	526
	Sep-03	(5)	823
	Dec-03	(5)	862
	Mar-04	(5)	698
	Jun-04	(5)	885
	Average		759

Sources:

(1)	Annual expense of $882 (DIV 2-17, p. 4), accrued over the fiscal year	
(2)	Response to DIV 2-11	
(3)	Attachment RJR-2	30627+165
(4)	Attachment RJR-2	$2,957 accrued over fiscal year
(5)	Response to Follow-up Information Requests 11/1/2004	

NEW ENGLAND GAS COMPANY
RATE OF RETURN

	Ratio	Cost Rate	Wtd. Cost
Short Term Debt	8.80%	2.02%	0.18%
Long Term Debt	45.70%	7.81%	3.57%
Preferred Stock	1.90%	9.93%	0.19%
Common Equity	43.60%	11.25%	4.91%
Total	100.00%		8.84%

Source: Settlement, Section II.F
Attachment RJR-1, Page 10 for Short Term Debt Rate