NATIONAL GRID - GAS

FY2015 REVENUE REQUIREMENT RECONCILIATION
GAS INFRASTRUCTURE, SAFETY AND RELIABILITY PLAN

RIPUC DOCKET NO. 4474

BEFORE THE
RHODE ISLAND PUBLIC UTILITIES COMMISSION

TESTIMONY OF DAVID J. EFFRON

ON BEHALF OF THE

DIVISION OF PUBLIC UTILITIES AND CARRIERS

SEPTEMBER 14, 2015

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DIRECT TESTIMONY
OF DAVID J. EFFRON

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I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

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

Q. What is your present occupation?

A. I am a consultant specializing in utility regulation.

Q. Please summarize your professional experience.

A. My professional career includes over thirty years as a regulatory consultant, two years as a supervisor of capital investment analysis and controls at Gulf & Western Industries and two years at Touche Ross & Co. as a consultant and staff auditor. I am a Certified Public Accountant and I have served as an instructor in the business program at Western Connecticut State College.

Q. What experience do you have in the area of utility rate setting proceedings?

A. I have analyzed numerous electric, gas, telephone, and water filings in different jurisdictions. Pursuant to those analyses I have prepared testimony, assisted attorneys in case preparation, and provided assistance during settlement negotiations with various utility companies.

I have testified in over three hundred cases before regulatory commissions in Alabama, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky, Maryland, Massachusetts, Missouri, Nevada, New Jersey, New York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Virginia, and Washington.

Q. Please describe your other work experience.

A. As a supervisor of capital investment analysis at Gulf & Western Industries, I was responsible for reports and analyses concerning capital spending programs, including project analysis, formulation of capital budgets, establishment of accounting procedures, monitoring capital spending and administration of the leasing program. At Touche Ross & Co., I was an associate consultant in management services for one year and a staff auditor for one year.

Q. Have you earned any distinctions as a Certified Public Accountant?

A. Yes. I received the Gold Charles Waldo Haskins Memorial Award for the highest scores in the May 1974 certified public accounting examination in New York State.

Q. Please describe your educational background.

A. I have a Bachelor's degree in Economics (with distinction) from Dartmouth College and a Masters of Business Administration Degree from Columbia University

II. PURPOSE OF TESTIMONY AND CONCLUSIONS

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Rhode Island Division of Public Utilities and Carriers ("the Division").

Q. What is the purpose of your testimony?

A. On August 3, 2015, The Narragansett Electric Company d/b/a National Grid ("National Grid," "Narragansett," or "the Company") submitted its Gas Infrastructure, Safety, and Reliability ("ISR") Reconciliation Filing for the fiscal year ("FY") ending March 31, 2015. I have reviewed the Company's calculation of the actual revenue requirement for FY 2015 in its ISR reconciliation. My testimony addresses the Company's treatment of the tax net operating loss ("NOL") in the calculation of the actual Fiscal Year 2015 revenue requirement.

III. NET OPERATING LOSSES

Q. Please describe what the NOLs represent.

A. As explained by Company Witness Little, Narragansett takes advantage of the available capital repairs deductions and bonus depreciation in calculating its taxable income. The benefits of these tax deductions are not immediately flowed through, but rather are credited to the balance of accumulated deferred income taxes ("ADIT"). The balance of ADIT is deducted from plant in service in the calculation of the required return on the net investment in plant and reduces the ISR revenue requirement accordingly. However, the capital repairs deductions and bonus depreciation can only be utilized to the extent that there is taxable income to absorb those deductions. If the capital repairs deductions and bonus depreciation, along with other income tax deductions, reduce the taxable income below zero, then there is a net operating loss. This is what happened to Narragansett in 2012, 2013, and 2014.

In effect, being in an NOL position meant that the Company was not able to fully utilize the capital repairs deductions and bonus depreciation in those years. However, the Company's calculations of the ADIT balances reflected full utilization of the capital repairs deductions and bonus depreciation. Therefore, to properly account for the effect of any NOLs on the ISR revenue requirement, it is necessary to recognize the effect of the NOLs by means of a separate offset to reduce the ADIT deducted from plant in service in the calculation of the required return on the net investment in ISR plant. This has the effect of increasing the ISR revenue requirement.

Q. Did the Company properly account for the NOLs in its previous ISR reconciliations?

A. No. The Company did not recognize the effect of the NOLs on the balance of ADIT deducted from plant in service in the ISR reconciliations for Fiscal Years 2012, 2013, and 2014.

Q. Is the Company proposing to correct the ISR reconciliation and to take account of its failure to recognize the effect of the NOLs in previous reconciliations in the ISR reconciliation for Fiscal Year 2015?

A. Yes. First, the Company has included the effect of the NOLs for Fiscal Years 2012, 2013, and 2014 in the calculation of the Fiscal Year 2015 revenue requirement for the FY 2012, FY 2013, and FY 2014 ISR vintages and has reduced the ADIT deducted from ISR plant in the calculation of the Fiscal Year 2015 return requirement for those vintages accordingly. The Company refers to this as the "FY 2015 cumulative revenue requirement." The impact for FY 2015 is $3.1 million.

Second, the Company has calculated a "one-time adjustment" for the previous understatement of the revenue requirements in the ISR reconciliations for Fiscal Years 2012, 2013, and 2014 and has added that "one-time adjustment" to the Fiscal Year 2015 ISR revenue requirement. This one-time adjustment increases the Fiscal Year 2015 revenue requirement by $3,537,706.

Q. Based on your review, has the Company calculated the "FY 2015 cumulative revenue requirement" of the NOLs correctly"?

A. Yes. The effects of the NOLs for Fiscal Years 2012, 2013, and 2014 on the Fiscal Year 2015 revenue requirement are shown on Attachment MAL-1, pages 9, 7, and 4, respectively

Q. Should the Company be allowed to recover the "one-time adjustment" for the previous understatement of the revenue requirements in the ISR reconciliations for Fiscal Years 2012, 2013, and 2014 prospectively?

A. As noted by the Company in its cover letter accompanying the Reconciliation Filing in Docket No. 4473 with regard to the Capital Expenditure ("CapEx") component of the ISR revenue requirement, "The CapEx Reconciling Factors recover or credit the difference between the reconciliation of actual billed revenue generated from the CapEx Factors and the actual Cumulative Revenue Requirement for the applicable plan year." The one-time adjustment is not a component of the actual revenue requirement for the applicable plan year being reconciled, which is Fiscal Year 2015. However, if "Cumulative Revenue Requirement" is interpreted to mean the cumulative revenue requirement since the inception of the ISR reconciliation mechanism, then the previous understatement of the revenue requirements in the ISR reconciliations for Fiscal Years 2012, 2013, and 2014 would be eligible for recovery, subject to the Commission's approval of the method of recovery.

Q. If the Company is allowed to recover the one-time adjustment for the previous understatement of the revenue requirements in the ISR reconciliations for Fiscal Years 2012, 2013, and 2014 prospectively, should the entire recovery take place in the Fiscal Year 2015 reconciliation?

A. No. As explained by Ms. Little, the one-time adjustment represents a catch-up for a revenue shortfall that took place over a number of years, as a result of the Company's failure to recognize the effect of the NOLs on the ISR revenue requirements in those years. The Company should not be allowed to recover the one-time adjustment for the previous understatement of revenue requirements over several years in one year.

If the Company is allowed to recover the one-time adjustment for the previous understatement of the revenue requirements in the ISR reconciliations for Fiscal Years 2012, 2013, and 2014 prospectively, I recommend that the recovery be spread over three years without carrying charges, with one-third of the recovery in the present reconciliation and one-third each in the 2016 and 2017 reconciliations. Doing so would reduce the "True Up for Net Operating Losses generated in FY 2012, FY 2013 and

FY 2014" on Attachment MAL-1, Page 1 in the present reconciliation by $2,358,471, from $3,537,706 to $1,179,235.

Q. But hasn't the Company stated that it would not be appropriate to spread the incremental revenue requirements related to the NOLs over a number of years?

A. In her direct testimony at page 10, Company Witness Little addresses this possibility and concludes that "deferring an amount of the FY 2015 revenue requirement impact will only result in the need for increased recovery in future years and would result in incremental carrying charges on amounts deferred." However, the criticisms of spreading the recovery over a number of years, which are presented on Page 10 at lines 3-12 of her testimony, pertain only to the "FY 2015 cumulative revenue requirement" but not to the "one-time adjustment." In fact, in her conclusion summarizing the Company's opposition to spreading the recovery out over a number of years, Ms. Little makes reference only to "deferring an amount of the FY 2015 revenue requirement." The one-time adjustment is not a component of the actual FY 2015 revenue requirement. Rather, as described above, it is a catch-up for a shortfall in revenues in previous years. The revenue requirement effect of the one-time adjustment can be spread out over a period of years without resulting in the need for increased recovery in future years, nor require any carrying charges, or having any other adverse compounding effect.

Q. Does this conclude your direct testimony?

A. Yes.