

BEFORE THE
STATE OF RHODE ISLAND
DIVISION OF PUBLIC UTILITIES AND CARRIERS

IN RE: Petition of PPL Corporation, PPL
Rhode Island Holdings, LLC, National Grid
USA, and The Narragansett Electric
Company for Authority to Transfer
Ownership of The Narragansett Electric
Company to PPL Rhode Island Holdings,
LLC and Related Approvals

Docket No. D-21-09

**DIRECT TESTIMONY AND SUPPORTING EXHIBITS OF
DAVID J. EFFRON**

**ON BEHALF OF
THE RHODE ISLAND DIVISION OF PUBLIC UTILITIES AND CARRIERS
ADVOCACY SECTION**

NOVEMBER 3, 2021

TABLE OF CONTENTS

	<u>PAGE</u>
I. STATEMENT OF QUALIFICATIONS	1
II. PURPOSE AND SUMMARY OF TESTIMONY	3
III. ISSUES RAISED BY THE PROPOSED TRANSACTION.....	5
A. ACQUISITION PREMIUM.....	5
B. VALUATION OF NARRAGANSETT ASSETS.....	6
C. PENSION AND PBOP ASSETS AND LIABILITIES	7
D. ACCUMULATED DEFERRED INCOME TAXES	10

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DIVISION OF PUBLIC UTILITIES AND CARRIERS

IN RE: Petition of PPL Corporation, PPL)
Rhode Island Holdings, LLC, National Grid)
USA, and the Narragansett Electric)
Company for Authority to Transfer) Docket No. D-21-09
Ownership of the Narragansett Electric
Company to PPL Holdings, LLC and
Related Approvals

**DIRECT TESTIMONY OF
DAVID J. EFFRON**

1 **I. STATEMENT OF QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

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

5 **Q. WHAT IS YOUR PRESENT OCCUPATION?**

6 A. I am a consultant specializing in utility regulation.

7 **Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.**

8 A. My professional career includes over thirty years as a regulatory consultant, two
9 years as a supervisor of capital investment analysis and controls at Gulf & Western
10 Industries and two years at Touche Ross & Co. as a consultant and staff auditor. I
11 am a Certified Public Accountant, and I have served as an instructor in the business
12 program at Western Connecticut State College. A copy of my resume is included as
13 Exhibit A to this testimony

1 **Q. WHAT EXPERIENCE DO YOU HAVE IN THE AREA OF UTILITY RATE**
2 **SETTING PROCEEDINGS?**

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

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

12 **Q. PLEASE DESCRIBE YOUR OTHER WORK EXPERIENCE.**

13 A. As a supervisor of capital investment analysis at Gulf & Western Industries, I was
14 responsible for reports and analyses concerning capital spending programs, including
15 project analysis, formulation of capital budgets, establishment of accounting
16 procedures, monitoring capital spending and administration of the leasing program.

17 At Touche Ross & Co., I was an associate consultant in management services for one
18 year and a staff auditor for one year.

19 **Q. HAVE YOU EARNED ANY DISTINCTIONS AS A CERTIFIED PUBLIC**
20 **ACCOUNTANT?**

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

3 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

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

6 **II. PURPOSE AND SUMMARY OF TESTIMONY**

7 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

8 A. I am testifying on behalf of the Advocacy Section of the Rhode Island Division of
9 Public Utilities and Carriers (“Advocacy Section”).

10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

11 A. On May 4, 2021, PPL Corporation (“PPL Corp.”) and PPL Rhode Island Holdings,
12 LLC (“PPL Rhode Island”), together (“PPL”), National Grid USA (“National Grid”)
13 and The Narragansett Electric Company (“Narragansett”) (collectively “Petitioners”)
14 submitted a petition to the Rhode Island Division of Public Utilities and Carriers (“the
15 Division”), requesting approval for Authority to Transfer Ownership of The
16 Narragansett Electric Company to PPL Rhode Island Holdings, LLC and Related
17 Approvals¹ (“Petition”). If the Petition is approved, National Grid will sell 100
18 percent of the outstanding shares of common stock in Narragansett to PPL Rhode
19 Island, which is a wholly owned indirect subsidiary of PPL (the “Transaction”).

¹ Petition of PPL Corporation, PPL Rhode Island Holdings, LLC, National Grid USA, and The Narragansett Electric Company for Authority to Transfer Ownership of The Narragansett Electric Company to PPL Rhode Island Holdings, LLC and Related Approvals, Division Docket No. D-21-09 (May 4, 2021).

1 Narragansett will continue to own and operate its utility assets and maintain all of its
2 franchise rights for the provision of electric and gas distribution service in Rhode
3 Island, under the management and control of PPL Rhode Island.²

4 The purpose of this testimony is to address certain accounting implications of the
5 proposed Transaction and explain why these matters should be addressed by the
6 Division in its determination of whether the proposed acquisition of Narragansett by
7 PPL is consistent with the public interest.

8 In the preparation of this testimony, I have not read the testimony or exhibits related
9 to any issues that may be addressed by other intervenors in this proceeding.
10 Therefore, I do not take a position on those issues, and the fact that I do address such
11 issues in this testimony should not be interpreted to mean that either the Advocacy
12 Section or I either support or oppose the positions of the intervenors on those issues.

13 **Q. PLEASE SUMMARIZE THE MATTERS THAT YOU ARE ADDRESSING**
14 **AND YOUR RECOMMENDATIONS ON THOSE MATTERS.**

15 A. The proposed transaction will result in the recording of a substantial acquisition
16 premium. The recording of the acquisition premium should not affect the
17 determination of the revenue requirement used to establish Narragansett's rates in
18 any way.

19 Any fair value adjustments recorded as a result of the Transaction should not affect
20 the valuation of any utility property carried on Narragansett's books of account.

² *Id.*

1 Narragansett's assets and liabilities related to pensions and other post-retirement
2 benefits will be restated to their fair market values at the time of the closing of the
3 Transaction. Any such restatements should not increase the pensions and other
4 postretirement benefits included in Narragansett's revenue requirement above what
5 they would be in the absence of the Transaction.

6 The balance of Accumulated Deferred Income Taxes ("ADIT") deducted from plant in
7 service in the determination of the Narragansett rate base for ratemaking purposes will
8 be eliminated as a result of the acquisition. A mechanism must be established to offset
9 the effect of the elimination of the ADIT and to hold ratepayers harmless from the
10 revenue requirement effect of the loss of this rate base deduction.

11 **III. ISSUES RAISED BY THE PROPOSED TRANSACTION**

12 **A. Acquisition Premium**

13 **Q. HOW WILL PPL RHODE ISLAND ACCOUNT FOR THE ACQUISITION**
14 **OF NARRAGANSETT FROM NATIONAL GRID USA?**

15 A. PPL Rhode Island will purchase of 100% of the outstanding shares of common stock
16 in Narragansett from National Grid. The purchase price will be greater than the fair
17 value of the assets less the fair value of the liabilities (the net book value) of
18 Narragansett, and the difference will be recorded as an acquisition premium, or
19 goodwill.

20 **Q. WHAT IS THE MAGNITUDE OF THE ACQUISITION PREMIUM THAT**
21 **WILL BE RECORDED AS A RESULT OF THE TRANSACTION?**

1 A. PPL estimates that the acquisition premium will be approximately \$1 billion (PPL's
2 response to Advocacy Section Data Request DIV 2-36³).

3 **Q. HAVE THE PETITIONERS DETERMINED HOW THE ACQUISITION**
4 **PREMIUM WILL BE TREATED FOR RATEMAKING PURPOSES IN THE**
5 **DETERMINATION NARRAGANSETT'S RATES?**

6 A. Yes. PPL will not seek to recover any acquisition premium or transaction costs in
7 customer rates.⁴

8 **Q. IS THIS APPROPRIATE?**

9 A. Yes. PPL Corp. and PPL Rhode Island have also represented that: 1) the acquisition
10 premium will not be pushed down to Narragansett's balance sheet and will be
11 retained on PPL Corp.'s corporate balance sheet (PPL's response to Advocacy
12 Section Data Request DIV 2-3); and 2) they will not seek to include the effect of the
13 acquisition premium in the capital structure used for ratemaking purposes (PPL's
14 response to Advocacy Section Data Request DIV 2-36, part b). These representations
15 are appropriate. Any acquisition premium recorded as a result of the transaction
16 should not impact the rates paid by customers in any way, and PPL's representations
17 should be formalized as enforceable commitments.

18 **B. Valuation of Narragansett Assets**

19 **Q. WILL PPL RECOGNIZE ASSETS ACQUIRED AND LIABILITIES**
20 **ASSUMED AT THEIR VALUES AS OF THE ACQUISITION DATE?**

³ A copy of all data responses cited in this testimony are contained in Exhibit C to this testimony.

⁴ Petition ¶ 38.

1 A. Yes (PPL's response to Advocacy Section Data Request DIV 2-3, part a). However,
2 PPL and PPL Rhode Island have stated that they do not expect that there will be any
3 differences between the fair market value of the acquired assets and the book value
4 of the acquired assets as of the closing date, although it is possible that there will be
5 minor differences in the book value and the fair market value arising due to tax
6 impacts related to book to tax differences arising in the acquisition. (PPL's response
7 to Advocacy Section Data Request DIV 4-5).

8 **Q. IF THERE IS A DIFFERENCE BETWEEN THE BOOK VALUE AND FAIR**
9 **MARKET VALUE, HOW SHOULD ANY SUCH DIFFERENCE BE**
10 **TREATED?**

11 A. The Transaction should not affect the value of utility property carried on
12 Narragansett's books of account, and that property should continue to be carried at
13 its original cost when first devoted to public utility service. PPL Corp. and PPL
14 Rhode Island have represented that, post-Transaction, the utility property on
15 Narragansett's books of account will continue to be stated at its original cost when
16 first devoted to public utility service (PPL's response to Advocacy Section Data
17 Request DIV 4-4). This representation should be formalized as an enforceable
18 commitment.

19 **C. Pension and PBOP Assets and Liabilities**

20 **Q. WILL THE MERGER AFFECT THE VALUATION OF ASSETS AND**
21 **LIABILITIES RELATED TO PENSIONS AND POSTRETIREMENT**

1 **BENEFITS OTHER THAN PENSIONS (“PBOP”) RECORDED ON THE**
2 **BALANCE SHEET OF NARRAGANSETT?**

3 A. Yes. Narragansett accounts for pensions and for PBOP pursuant to applicable
4 accounting standards. These accounting standards require certain actuarial
5 assumptions to determine the pension and PBOP liabilities and periodic costs. The
6 assumptions include discount rates, return on invested funds, mortality, inflation, and
7 other factors that go into the calculation of the liabilities and the periodic costs. The
8 actual experience in the real world never exactly matches the actuarial assumptions,
9 and the assumptions will have to be adjusted from time to time based on actual
10 experience and changing circumstances. The accounting standards do not require
11 that the entire difference between the assumptions and actual experience or the
12 cumulative effect of changes in actuarial assumptions be recognized immediately for
13 financial reporting purposes. Rather, the effect of these differences is recognized
14 over time. However, merger/acquisition accounting requires that that assets and
15 liabilities be stated at their fair value at the time of the merger or acquisition.

16 **Q. SHOULD ANY ADJUSTMENTS TO RESTATE THE BALANCE SHEET**
17 **ASSETS AND /OR LIABILITIES FOR PENSIONS AND OTHER**
18 **POSTRETIREMENT BENEFITS INCREASE THE NARRAGANSETT**
19 **REVENUE REQUIREMENT ABOVE WHAT IT WOULD BE IN THE**
20 **ABSENCE OF THE TRANSACTION?**

1 A. No. A regulatory asset or liability should be established to offset any adjustments to
2 pension and PBOP assets and liabilities recorded in association with the acquisition.
3 The purpose of this accounting treatment should be to maintain the periodic pension
4 expense and periodic PBOP expense included in Narragansett's revenue requirement
5 at a level no higher than the level that would exist in the absence of the Transaction.

6 **Q. DO PETITIONERS AGREE THAT THE ANY ADJUSTMENTS TO**
7 **RESTATE THE BALANCE SHEET ASSETS AND /OR LIABILITIES FOR**
8 **PENSIONS AND OTHER POSTRETIREMENT BENEFITS SHOULD NOT**
9 **INCREASE THE NARRAGANSETT REVENUE REQUIREMENT ABOVE**
10 **WHAT IT WOULD BE IN THE ABSENCE OF THE TRANSACTION?**

11 A. Advocacy Section Data Request DIV 9-35 asked: "Do PPL Corporation and PPL
12 Rhode Island Holdings, LLC agree that any adjustments to restate the balance sheet
13 assets and/or liabilities for pensions and other postretirement benefits as referenced
14 in the response to [Advocacy Section Data Request DIV] 4-9, will not increase the
15 Narragansett revenue requirement above what it would be in the absence of the
16 Transaction?"

17 In the response, PPL Corp. and PPL Rhode Island stated that "the pension plan and
18 postretirement benefits will be re-measured upon acquisition after Transaction
19 closing, which is similar to the annual re-measurement performed by Narragansett
20 under National Grid ownership currently. The Transaction itself is not causing an

1 increase or decrease in pension and postretirement benefit obligations that would
2 cause a change to Narragansett's revenue requirement.”⁵

3 **Q. DOES THIS RESPONSE ASSURE THAT THE PERIODIC PENSION**
4 **EXPENSE AND PERIODIC PBOP EXPENSE INCLUDED IN**
5 **NARRAGANSETT'S REVENUE REQUIREMENT WILL BE NO HIGHER**
6 **THAN THE LEVEL THAT WOULD EXIST IN THE ABSENCE OF THE**
7 **TRANSACTION?**

8 A. No. The annual re-measurement of plan assets and liabilities referenced by PPL does
9 not require the immediate recognition of actuarial gains or losses. Thus, the
10 restatement of plan assets and liabilities to fair value upon acquisition after
11 Transaction closing may be more extensive than the annual re-measurement currently
12 being performed and has the potential to affect the annual pension and PBOP expense
13 going forward.

14 There should be an enforceable commitment that any restatement of plan assets and
15 liabilities to fair value upon acquisition after Transaction closing will not increase
16 Narragansett's revenue requirement to a level higher than the level that would exist
17 in the absence of the Transaction.

18 **D. Accumulated Deferred Income Taxes**

19 **Q. WILL THE PROPOSED TRANSACTION AFFECT THE BALANCE OF**
20 **ADIT DEDUCTED FROM PLANT IN SERVICE FOR THE PURPOSE OF**

⁵ PPL's response to Div. 9-35.

1 **DETERMINING THE NARRAGANSETT RATE BASE USED TO**
2 **ESTABLISH RATES?**

3 A. Yes. PPL Rhode Island and National Grid have agreed to make an election under
4 section 338(h)(10) of the Internal Revenue Code to have the Transaction treated as
5 an asset sale for federal income tax purposes.⁶

6 Presently, the tax basis of Narragansett's plant in service is significantly less than the
7 book basis, due to book/tax timing differences such as accelerated depreciation,
8 bonus depreciation, and capital repairs deductions. As a result, when National Grid
9 sells the assets to PPL at book value, there will be a taxable gain equal to the
10 difference between the book value and the tax basis. In effect, the liability for
11 deferred income taxes, which was recorded to account for the book/tax timing
12 differences, will become due and payable when the Transaction closes. Further,
13 when PPL acquires Narragansett, a new tax basis will be established for the acquired
14 assets, including plant in service, equal to the acquisition cost. Thus, immediately
15 after the Transaction closes, the tax basis of the assets acquired will be equal to the
16 book basis.

17 As new the tax basis immediately following the acquisition will equal the book basis,
18 there will be no balance of ADIT at that time. The balance of ADIT deducted from
19 Narragansett's rate base for ratemaking purposes will be eliminated. This also

⁶ Petition ¶ 11.

1 reflects the fact that the ADIT liability had been paid by National Grid as result of
2 the sale of Narragansett's assets to PPL at book value.

3 It should be noted that the elimination of the ADIT at the time of the acquisition does
4 *not* apply to the balances of excess ADIT. Technically, the balances of excess ADIT
5 do not actually represent deferred tax liabilities. Rather, the excess ADIT balances
6 represent regulatory liabilities for income taxes that had been recovered in rates but
7 are no longer payable as income taxes and must be returned to ratepayers.

8 **Q. WHAT IS THE EFFECT OF ELIMINATING THE BALANCE OF ADIT AT**
9 **THE TIME OF THE ACQUISITION OF NARRAGANSETT'S ASSETS BY**
10 **PPL?**

11 A. As of June 30, 2021, Narragansett's rate base ADIT liability was approximately
12 \$368.0 million (National Grid's response to Advocacy Section Data Request DIV 9-
13 36). Based on the currently authorized rates of return, elimination of this rate base
14 deduction, other things equal, would increase Narragansett's revenue requirement by
15 approximately \$30 million in the first year after the merger.

16 The effect of the elimination of the ADIT at the time of the acquisition will diminish
17 over the years, as the deferred taxes on the acquired assets re-accumulate. In addition,
18 the balance of ADIT existing at the time of acquisition would reverse over time even
19 in the absence of the acquisition. Eventually, the ADIT balance will become greater
20 than it would have been in the absence of the Transaction. However, in the earlier
21 years following the Transaction, the loss of the ADIT would impose substantial

1 additional costs on ratepayers in the absence of any mechanism to address the loss of
2 the ADIT.

3 **Q. DOES PPL AGREE THAT RATEPAYERS SHOULD BE HELD HARMLESS**
4 **FROM THE ELIMINATION/REDUCTION TO THE BALANCE OF ADIT?**

5 A. Yes. PPL has stated that in a future proceeding setting base rates, it will make a
6 proposal to hold customer impacts neutral in relation to the rate impact associated
7 with the elimination of ADIT as of the date of the Transaction (PPL response to
8 Advocacy Section Data Request DIV 2-3, part c).

9 **Q. HAS PPL IDENTIFIED THE MECHANISM THAT WILL BE**
10 **IMPLEMENTED TO “HOLD CUSTOMER IMPACTS NEUTRAL”?**

11 A. No. PPL Corp, and PPL Rhode Island have not yet identified the mechanism they
12 will use to hold customer impacts neutral from the increase to Narragansett’s rate
13 base from the reduction/elimination of ADIT as a result of the Transaction (PPL’s
14 response to Advocacy Section Data Request DIV 4-7).

15 **Q. DO YOU HAVE A RECOMMENDATION AS TO A MECHANISM THAT**
16 **CAN BE UTILIZED TO HOLD CUSTOMERS HARMLESS FROM THE**
17 **REDUCTION/ELIMINATION OF ADIT AS A RESULT OF THE**
18 **TRANSACTION?**

19 A. Yes. First, the amount of ADIT on the acquired assets that would have accumulated
20 from the time of the acquisition going forward under continuing National Grid
21 ownership should be calculated. Second, the amount of ADIT on the acquired assets

1 accumulated from the time of the acquisition going forward under PPL ownership
2 should be calculated. The difference between those two values should be deducted
3 from the Narragansett rate base used for ratemaking purposes until the time that the
4 present value of the future differences between the two is immaterial (for example,
5 \$100,000 or less).

6 **Q. HAVE YOU PREPARED AN ILLUSTRATIVE EXAMPLE OF HOW THE**
7 **MECHANISM WOULD BE IMPLEMENTED?**

8 A. Yes. I have constructed an example on my Schedule DJE-1 of how the hold harmless
9 mechanism would work.⁷ The values shown on the schedule are for illustrative
10 purposes only and are not intended as a representation of what the actual values will
11 be. In this illustrative case, I have assumed that the balance of ADIT as of December
12 31, 2021 will be same as the balance as of June 30, 2021.

13 Referring to this illustrative case, if, for example, Narragansett has a future rate
14 case with calendar 2023 as a rate year, the rate base deduction would be the average
15 of the differences in the balances of ADIT as of December 31, 2022 and December
16 2023, or \$331.5 million. This amount would appear as a rate base deduction labeled
17 “ADIT Transaction Adjustment” or something similar. If necessary, the balance as
18 of any date in the year other than December 31 could be calculated by interpolation.

19 In this example, the balance as of March 31, 2022 would be $\frac{3}{4} * \$345.1 \text{ million} +$
20 $\frac{1}{4} * \$317.8 \text{ million}$, or \$338.3 million.

⁷ Schedule DJE-1 is provided as Exhibit B to this testimony.

1 In this illustrative example, the present value of the return on the ADIT differential
2 is relatively immaterial in the years subsequent to 2037. Therefore, the rate base
3 deduction for the ADIT differential would cease as of the end of 2037.

4 **Q. ARE CERTAIN ASSUMPTIONS NECESSARY IN THE CALCULATIONS**
5 **OF THE ADIT UNDER CONTINUING NATIONAL GRID OWNERSHIP**
6 **AND UNDER PPL OWNERSHIP?**

7 A. Yes. For example, the exact pattern of future retirements of the acquired assets will
8 not be known at the time of the acquisition. In calculating the future balances of
9 ADIT under continuing National Grid ownership and under PPL ownership, any
10 assumptions regarding such matters should be internally consistent. In this example,
11 the forecasted pattern of future retirements under PPL ownership should be the same
12 as they would have been under continuing National Grid ownership for the purpose
13 of calculating the ADIT Transaction Adjustment.

14 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

15 A. Yes.

16