BOSTON EDISON COMPANY

CAMBRIDGE ELECTRIC LIGHT COMPANY

COMMONWEALTH ELECTRIC COMPANY

NSTAR GAS COMPANY

Direct Testimony of Michael F. Farrell

Exhibit NSTAR-MFF-1

D.T.E. 05-85

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Exhibit NSTAR-MFF-2	2004 - 2005 NSTAR Allocation Report
Exhibit NSTAR-MFF-3	2004 Cost Area Allocations Overview
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Exhibit NSTAR-MFF-5	2004 Summary of Allocation Factors
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Q. Please state your name and business address.

A. My name is Michael F. Farrell. My business address is One NSTAR Way, Westwood, Massachusetts 02090.

Q. By whom are you employed and in what capacity?

A. I am the Assistant Controller & Director, Accounting of NSTAR and its subsidiaries, Boston Edison Company ("Boston Edison"), Cambridge Electric Light Company ("Cambridge"), Commonwealth Electric Company ("Commonwealth"),, collectively "NSTAR Electric", and NSTAR Gas Company ("NSTAR Gas"; together with NSTAR Electric, the "Companies"). I am responsible for all aspects of accounting and income taxes for the Companies. I have direct responsibility for general accounting, income taxes, plant accounting and payroll. In addition, I am responsible for the Companies' affiliates' annual and quarterly financial reporting to the Federal Energy Regulatory Commission ("FERC") and the Department of Telecommunications and Energy (the "Department").

Q. Please describe your education and professional background.

A. I graduated from Bentley College in 1987 with a B.S. in Accountancy. Upon completing my degree, I worked in the Public Utilities Practice of the Boston office of Coopers & Lybrand (now PricewaterhouseCoopers) from 1987 to 1994. While at Coopers & Lybrand, I provided accounting, auditing and rate design

services to several utilities in New England, including companies under the jurisdiction of the Department.

In 1994, I joined New England Power Service Company ("NEPSCO") as a Senior Financial Analyst. In this capacity, I was responsible for the Revenue Requirements of Massachusetts Electric Company. I served as the cost-of-service witness in D.P.U. 95-40 and testified before the Department on such matters as accounting, income and property taxes and NEPSCO cost allocation to its affiliates.

Since joining the Companies in 1996, I have provided testimony to the Department on such matters as the formation of a holding company structure, affiliate transactions and employee pension and benefit accounting in the following proceedings: D.P.U. 97-63, D.P.U. 97-95 and D.T.E. 03-47-B.

I am also a Certified Public Accountant in the Commonwealth of Massachusetts.

Q. Have you previously testified in any formal hearings before regulatory bodies?

A. Yes, as described above, I have testified before the Department on a number of occasions. In addition, I also testified in the following proceeding before FERC regarding the inclusion of construction work in progress in rate base: ER 05-69-000.

Q. Please describe the purpose of your testimony in this proceeding.

A. My testimony supports the allocation of costs from "NSTAR Electric & Gas Company", the service company for the Companies, to the various NSTAR subsidiaries and supports the allocations made to the distribution companies in this case. My testimony will also describe the processes in place to track the costs, assignments and allocations among and between the Companies and confirm that those allocations are accurate and reasonable in ensuring the proper assignment of costs and benefits among NSTAR affiliates.

Q. Are you directly responsible for the service company allocations?

A. Yes, the booking of the service company costs is performed in my department and under my supervision.

Q. How are these allocations performed?

A. Exhibit NSTAR-MFF-2 titled the "2004 - 2005 NSTAR Allocation Report" explains the method and logic for the allocations. This is an update to the allocation report that was filed with the Department in March 2004 as required under the order approving the merger of BEC Energy and Commonwealth Energy System in docket D.T.E. 99-19.

Q. What are the standards set forth by the Department's decision in D.T.E. 99-19 with regard to the processes used to track and allocate costs?

A. Although I am not an attorney, I am familiar with the Department's order in that case, which determined that:

> In order to recover costs incurred from an affiliate, a company must show that those costs: (1) are specifically beneficial to the individual company seeking rate relief (as opposed to other subsidiary members of the system as a whole); (2) compare reasonably to competitive prices; and (3) are allocated by a formula that is cost-effective and nondiscriminatory…. In preparing this system, the Joint Petitioners must functionalize all costs, classify the expenses in each functional category, identify the appropriate allocators, and allocate all costs…. Furthermore, the Joint Petitioners must explain the underlying criteria or rationale for the choice of allocators used to assign the costs among the operating companies.

See Joint Petition of Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company and Commonwealth Gas Company, D.T.E. 99-19, at 93 (1999).

In this order, the Department also noted that the establishment of a cost allocation method required sufficient experience with regard to the integration of operations and the appropriate allocation of cost responsibility among the subsidiaries. Id. Thus, the NSTAR Allocation Report was required to meet the above-referenced standard. Id. at 94.

Q. Have you updated the March 2004 NSTAR Allocation Report?

A. Yes, there are some small format changes such as adding paragraph numbering for easier review and some minor changes given the reorganization of certain service departments in the normal course of business. For example, the Procurement group moved from the Controller's organization to the Energy Supply group and the Transmission group moved from the Energy Supply group to the Strategic and Regulatory Planning group.

Q. Are there any changes in the allocation methods and logic?

A. There are no significant changes. The Companies continue to apply substantially the same allocation methods and logic as explained in the NSTAR Allocation Report filed with the Department in March 2004.

Q. Please explain the NSTAR Allocation Report, Exhibit NSTAR-MFF-2.

A. This report has four sections: (1) Introduction; (2) NSTAR Organization and Corporate Structure; (3) Cost Attribution Process; and (4) Cost Area Overview.

Q. Please explain the "Introduction."

A. The "Introduction" explains the purpose of the report, which is to describe and explain the allocation methods and its application to individual cost areas.

Q. Please explain the "NSTAR Organization and Corporate Structure."

A. This section explains the organization of NSTAR, including the parent, the utilities, the non-regulated companies and the service company. The four distribution utilities operate on a centralized and integrated basis as if they were a single entity in many areas of their utility business. The Companies have structured their utility business operations in this way in order to achieve system-wide efficiencies through economies of scale, elimination of duplicate functions and best business practices. This structure forms the backdrop to the "Cost Attribution Process."

Q. Please explain the "Cost Attribution Process."

A. A large majority of the costs incurred to provide service to customers are directly assigned to the regulated or unregulated operating company. For items such as rate base, property taxes, depreciation and the majority of electric and gas distribution O&M expenses, the Companies' accounting system directly records costs on the books of the individual distribution company. As a key part of the merger of BEC Energy and Commonwealth Energy System in 1999, the Companies determined that it would be cost effective and efficient for certain business functions of the Companies' separate operating companies to be performed on a centralized basis. The Companies created "NSTAR Services Company," which name was subsequently changed to "NSTAR Electric and Gas Corporation" ("NE&G"), to perform these centralized functions. NE&G provides a variety of services to the operating companies, including: (1) finance and accounting; (2) human resources; (3) legal services; (4) information technology; (5) purchasing from outside vendors; (6) customer care; and (7) other administrative services. These services are specifically beneficial to the individual Companies, are reasonably priced, ensure the cost-effective delivery of service to customers and are allocated by a non-discriminatory formula, as discussed further below. The services provided by NE&G are similar to those that were previously provided to Commonwealth, Commonwealth Gas Company (now NSTAR Gas) and Cambridge by COMEnergy Services Company.

Q. Are the costs charged by NE&G competitively priced within the industry?

A. Yes, since the costs charge by NE&G are cost-based, are consistent with traditional cost-of-service principles and are subject to the Department's review and approval, they satisfy these standards. Indeed, the use of a service company and the resulting efficiencies made possible by the NSTAR merger were key considerations supporting the Department's merger approval in D.T.E. 99-19.

Q. How are the Companies' charged for the services they are provided by NE&G?

A. When NE&G incurs costs for goods or services for a specific distribution company, these costs are directly assigned to that company, thereby ensuring that the costs incurred specifically benefit the company being charged. For example, employees of NE&G are required to "direct charge" their time on weekly time sheets to the specific distribution company for which they worked when it can feasibly be determined. When costs are incurred to serve the Companies more broadly, such costs are allocated among the Companies based on an allocation methodology. Each cost area is assigned an allocation factor that serves as a measure for how costs in that area are incurred on behalf of each applicable operating company. The term "cost area" refers to a department of the operating company for which costs are separately tracked. Each department is consolidated under an organization for which a Vice President or Senior Vice President is responsible. The allocation factor is applied to the total costs within the cost area to determine the proportional responsibility of each operating company. The

charges resulting from the allocation methodology reflect the actual costs incurred by NE&G. The costs incurred are not adjusted or otherwise "marked-up" to obtain additional revenues from the operating companies.

Q. Please describe the allocation factors that NE&G uses to allocate indirect costs to the operating companies?

A. The "2004 Summary of Allocation Factors" in Exhibit NSTAR-MFF-5 and "2005 Summary of Allocation Factors" in Exhibit NSTAR-MFF-6 provide detailed summaries of the allocation formulas. The resulting allocations are provided in Exhibits NSTAR-MFF-3 and NSTAR-MFF-4. Table 1 of Exhibit NSTAR-MFF-2 shows the ten NE&G Functions and a description of each function's primary activities. These formulas are specifically designed to be objective and non-discriminatory.

Q. Are all costs incurred by NE&G allocated among each of NSTAR's subsidiaries?

A. No. In some cases, the costs incurred by NE&G can be directly assigned to a particular operating company. For example, all costs that are booked to Gas Operations are directly assigned to NSTAR Gas. Similarly, some of the activities performed within a particular function may not be allocated to all of the subsidiaries because not all of the subsidiaries are receiving the benefit of the service. For example, costs relating to the Customer Care organization are allocated exclusively among the four retail utility operating companies because there are no "retail customers" associated with the unregulated subsidiaries that

are served by NE&G Customer Care personnel. The unregulated subsidiaries manage their own customer relationships. A summary of the resulting allocations among the Companies' regulated operating companies and other subsidiaries is shown on pages 1 and 2 of Exhibits NSTAR-MFF-3 and NSTAR-MFF-4.

Q. Please describe the formulae used by NE&G to allocate costs among the subsidiaries.

A. As reflected in Exhibits NSTAR-MFF-5 and NSTAR-MFF-6, the allocation methodologies are designed to reflect cost causation within a particular function. For example, the Human Resources function uses an allocator based on the direct labor charged to each company. Allocations are made only after it is determined that it is not reasonably possible to perform a direct assignment of NE&G costs.

Q. How often are the allocation factors reviewed and adjusted?

A. The allocation factors are adjusted on an annual basis utilizing the actual financial and statistical data of the most recently completed fiscal year. The review and adjustment of the factors is performed during the early part of each year. This review and adjustment includes meeting with department managers to determine whether the established allocation methods are reasonable for the amount of support provided to each subsidiary. In addition, the factors are recalculated to reflect the actual data from the previous year.

Q. Are the actual NE&G billings adjusted to reflect the outcome of this review?

A. Yes. If necessary, a retroactive adjustment is made to adjust the billings back to January to reflect the updated factors. This is typically performed during the second quarter each year, when the prior year's financial and statistical data are finalized.

Q. How are NE&G costs allocated between regulated and unregulated affiliates?

A. During the test year, 98.62 percent of costs were allocated to regulated entities as shown on page 1 of Exhibit NSTAR-MFF-7. The regulated entities include: Boston Edison; Commonwealth; NSTAR Gas; Cambridge; Canal Electric Company; Harbor Electric Energy Company; BEC Funding (which administers the securitized bonds); and Hopkinton LNG. The entities that are unregulated are: NSTAR Communications; Northwind (which is in the process of being dissolved); NSTAR Parent; NSTAR Steam (the Blackstone portion of which has been sold (see D.T.E. 02-76) and the remaining portion was sold in 2005); and Advanced Energy Systems ("AES") (see Exhibit NSTAR-MFF-8 for an illustration of NSTAR's corporate structure). The vast majority of NE&G functions are performed for the benefit of the four regulated utility operating companies. The remaining nine subsidiaries generally require limited facilities and few employees because of the limited nature of their operations in comparison to the utilities. The vast majority of employees and facilities that provide services to the unregulated subsidiaries are dedicated fully to those

subsidiaries. In fact, the majority of employees who provide services to AES are actually AES employees with completely separate employee benefit plans. Therefore, these facilities and employees are directly assigned to the individual companies and do not require many of the services provided by NE&G.

Of the nine unregulated subsidiaries, only NSTAR Communications, NSTAR Steam Company (prior to the sale of its remaining assets in September 2005) and AES operate with substantial physical assets and employees that perform business functions outside of core utility operations of the Companies. As a result, the total NE&G costs are allocated primarily to the regulated operating companies rather than the remaining subsidiaries. However, where appropriate, NE&G costs are allocated among the various affiliates, including unregulated affiliates, using considerations of the number of customers, operating revenues and overall capitalization as a proxy to estimate the proportionate support to these affiliates. In addition, there are allocations of certain cost areas to the unregulated subsidiaries even when there is no direct support provided to those subsidiaries by those functions. This occurs when it is determined that NE&G itself is getting a benefit of the function.

Q. Are the formulae similar to those previously used by the Commonwealth Energy System before the merger?

A. Yes, the allocation factors are similar to those that were used by ComEnergy Services. Allocators utilized include capitalization, labor charges and number of

customers. However, it is not possible to perform a one-for-one comparison of the allocation factors between ComEnergy Services and NE&G since the organization and management structures of the two companies are not identical.

Q. Please explain Exhibits NSTAR-MFF-3 and NSTAR MFF-4.

A. These exhibits show the results of the allocations for the test year. Because the test year is a "split" test year, half being in 2004 and half in 2005, there are two sets of annual allocators, each designated as a separate exhibit.

Q. Do you believe that current service company processes accurately allocate the costs and accounts of the various Companies?

A. Yes. The allocation of costs from NE&G to the various Company subsidiaries and distribution companies appropriately assigns costs and benefits in a manner to ensure the proper distribution of payments and services between the operating companies. This allows the Companies to take advantage of economies of scale with respect to centralized functions such as finance and accounting, human resources, legal services, information technology, procurement, customer care and other administrative services. The efficient use of expertise, equipment and personnel results in lower costs to secure these services from NE&G than the Companies would incur if they secured these services separately. This result is highly beneficial to customers.

Q. Does the Companies' allocation of costs meet the Department's standard for recovering cost incurred from an affiliate, as set forth in D.T.E. 99-19.

A. Yes, the Companies have satisfied these requirements because those costs: (1) are specifically beneficial to each of the individual Companies seeking rate relief and not other subsidiary members; (2) compare reasonably to competitive prices; and (3) are allocated by a formula that is cost-effective and nondiscriminatory. See D.T.E. 99-19, at 93.

Q. Does this conclude your testimony?

A. Yes, it does.