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December 9, 2013

Mark D. Marini, Secretary
Department of Public Utilities
One South Station, 2nd Floor
Boston, Massachusetts 02110

Re: Bay State Gas Company d/b/a Columbia Gas of Massachusetts, D.P.U. 13-75

Dear Secretary Marini:

Enclosed please find the Attorney General's Reply Brief in the above referenced matter.

Thank you for your attention to this matter. Please do not hesitate to contact me if you have any questions about this filing.

Sincerely,

Joseph W. Rogers
Assistant Attorney General

Enclosure
cc: Mark Tassone, Hearing Officer
Robert Keegan, Danielle Winter

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Bay State Gas Company	)	**D.P.U. 13-75**
d/b/a Columbia Gas of Massachusetts	)	

CERTIFICATE OF SERVICE

I certify that I have this day served the foregoing documents upon each person designated on the official service list compiled by the Secretary in this proceeding. Dated at Boston this 9th day of December 2013.

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COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Bay State Gas Company, d/b/a Columbia Gas of Massachusetts	))))	**D.P.U. 13-75**

REPLY BRIEF OF THE ATTORNEY GENERAL

Respectfully submitted,
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COMMONWEATH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Bay State Gas Company, d/b/a Columbia Gas of Massachusetts	))))	**D.P.U. 13-75**

REPLY BRIEF OF THE ATTORNEY GENERAL

I. INRODUCTION

Pursuant to the briefing schedule established by the Department of Public Utilities ("Department") in this proceeding, the Attorney General's Office ("AGO") submits its Reply Brief responding to arguments made by Bay State Gas Company ("Bay State" or "the Company") in its Initial Brief filed December 2, 2013 and to the initial brief filed by the Massachusetts Department of Energy Resources ("DOER") on November 15, 2013.

This Reply Brief is not intended to respond to every argument made or position taken by the Company in its Initial Brief. Rather, it is intended to respond only to the extent necessary to assist the Department in its deliberations, i.e., to provide further information, to correct misstatements or misinterpretations, or to provide omitted context. Therefore, silence by the AGO in regard to any particular argument or position in the initial brief of the Company should in no way be interpreted as assent on such arguments and positions.

Although the Company's Brief is 213 pages, it fails to address many of the arguments made in the AGO's Initial Brief. The purpose of briefs is to permit each party to identify its arguments, thus establishing the legal positions of that particular party.

Massachusetts Electric Company, D.P.U. 09-39, Hearing Officer Ruling, p. 2 (October 19, 2009). The Company is aware that reserving arguments for reply briefs is an improper attempt to defeat the rights granted to parties under G.L. c. 30A, § 11(1). Department should not permit the Company to circumvent the staggered briefing schedule that it established, and it should disregard all arguments made by the Company on issues that it failed to address in its Initial Brief, and which are not responsive to matters raised by respondents in their reply briefs. *See New England Telephone and Telegraph Company d/b/a Bell Atlantic-Massachusetts*, D.T.E. 98-15 (Phase I), pp. 10-11 (1998) ("The Department disfavor[s] any party's attempt to have the last word by saving for a reply brief arguments that could have been raised in an initial filing"). The AGO also reserves its right to file a motion to strike the Company's Reply Brief or take other appropriate action should the Company address issues for the first time on reply. The Company may not deny the AGO a reasonable opportunity to address all of the Company's arguments. *Id*.

In its Initial Brief, the Company spends more time casting aspersions than it does on analyzing the record evidence in this proceeding. While the Company rails against the so-called "fictions" in the AGO's Initial Brief, it turns a blind eye to salient facts: it has filed two base rate cases since it was granted its revenue decoupling mechanism and Targeted Infrastructure Reinvestment Factor ("TIRF"), while only one other utility—Fitchburg Gas and Electric Light Company's electric division—has even filed for one such rate case since receiving similar reconciliation mechanisms. Indeed, there are still utilities—Berkshire Gas and NSTAR Gas—that are functioning without the benefit of such mechanisms.[1] All of this, of course, points to the failure of Bay State's management to efficiently and effectively operate a local distribution gas company in this current regulatory environment. However, the Company refuses to acknowledge that its own faults, such as its ever increasing service company costs, have contributed to its claimed dire straits, which Mr. Bryant histrionically noted during evidentiary hearings. Instead of honestly appraising its own subpar performance, the Company has taken to blaming the Department for failing to give it "an opportunity to earn a fair return on its investment;" and thus, it requested a future test year in D.P.U. 12-25 and is seeking to, *inter alia*, adjust the TIRF cap and implement a Deferred In-Service Cost ("DISC") mechanism in the instant docket. These are all ratemaking crutches that other Massachusetts utilities do not seem to need.[2] In the end, the Company's position that the Department—rather than its own management—is to blame for its failure to earn a fair return on its investment may be the biggest and most self-serving fiction of all.

[1] The Company argues that it's like New England Gas Company ("NEGC"), which it claims is the example of a utility that filed several rate cases in order to "align" its rates with its "restructured" operations. Co. Br., p. 4, n. 2. What the Company fails to mention is that while NEGC did, in fact, file three rate cases in four years, D.P.U. 07-47, D.P.U. 08-35 and D.P.U. 10-114, one rate case, D.P.U. 10-114 was required by the Department's restructuring order in D.P.U. 07-50-A (*See* D.P.U. 07-50-A, pp. 24-25 and that it has not filed a new rate case since it the Department approved a TIRF mechanism in that case. D.P.U. 10-114. NEGC has stayed out for over three years since it was granted a TIRF. The same cannot be said of Bay State.

[2] The Department should note that Bay State claims never to be able to earn an adequate return under whatever ratemaking methodology the Department has adopted. *See Bay State Gas Company*, D.P.U. 07-89 (2008) (Bay State was the only Massachusetts utility that ever sought relief from a performance-based rate plan). In contrast, Berkshire Gas Company, with neither a TIRF nor a decoupling mechanism, has stayed out of a base rate proceeding since 2001.

II. ARGUMENT

A. The Department Should Eliminate Some of Bay State's Automatic Adjustment Mechanisms

In its Initial Brief, the AGO recommended that the Department eliminate the Company's Pension & Post-Retirement Benefits Other than Pension ("PBOP") Expense Factor, TIRF, and Revenue Decoupling Adjustment Factor because the Company continues to make annual base rate filings. AGO Br., p. 8. These annual rate case filings in addition to a raft of annual adjustment mechanism filings create an undue administrative burden for the Department and AGO and also increase rate case and investigative expenses that are reflected in customer rates. These annual adjustments can easily be made in the annual rate case filings; therefore, there is no need for the Department to open three additional dockets when all these reconciliations can be handled in one base rate case. After all, the purpose of these adjustment mechanisms was to reduce the frequency of rate cases—that has not happened in regards to Bay State. *See NSTAR Gas & Electric*, D.T.E. 03-47-A, p. 17, n. 17 *citing Worcester Gas Light Company*, D.P.U. 11209 (1955) (Adjustment mechanisms are a "useful as a way to avoid repetitive and costly general rate proceedings.").

In response, the Company argues that eliminating these adjustment clauses will harm its financial condition. Co. Br., pp. 15-16. However, the Company does not establish based on the record that it will in fact be worse off when it files a rate case every year. It is hard to claim that there is financial harm if recovery of the same amounts and costs currently recovered in the three separate adjustment mechanisms are instead recovered in one base rate case. And it is much more administratively efficient.

What the Company fails to discuss in its Brief is what the record evidence shows. Bay State has a plan to file annual rate cases for many years to come.[3] *See* Exh. AG-1-10 (A) Confidential, p. 52 of 109; Exh. AG-1-10 (B) Confidential, p. 52 of 109; Exh. AG-1-10 (C) Confidential, p. 52 of 109. Because the Company does not challenge this fact in its Brief, the Department is free to design a rate making régime that reflects this corporate plan of annual rate increases. Tr. Vol. I, pp. 10-11. Indeed, in its Brief, the Company asserts its right to file as many rate cases as it deems necessary to achieve what it deems to be "just and reasonable rates." Co. Br., p. 14. The AGO recognizes that eliminating these reconciling mechanisms would give the Company the pretense to file annual rate case filings, but if the Company is going to file annual rate cases anyway, eliminating them would undoubtedly be more administratively efficient. Ultimately, if Bay State wants to file a rate case every year, it is free to do so, but the Department also has the right to relieve its administrative burden.

The Department should recognize that the Company's purpose for this rate case and future annual rate cases is punitive—to punish the Department for its decision in D.P.U. 12-25. Bay State's foreign parent, NiSource, did not get what it wanted and it is going to punish the Department with rate cases until NiSource gets its way. Although the Company claims this case is all about closing a "revenue gap," (Co. Br., p. 16-17) that is an after-the-fact rationalization. The decision to file this rate case was made immediately after the Department's November 1, 2012 Order in D.P.U. 12-25 was issued and before Bay State had final numbers for the 2012 test year or seen revenues from the D.P.U. 12-25 rate increase. That is, the Company already determined that it would file another rate

[3] Indeed, the continued retention of John Skirtich and David Mouser suggest the Company is on a kind of "permanent rate case" footing. Co. Br., pp. 104-107.

case, before it was possible to determine whether there was a revenue gap for the test year. In fact, eight days after the decision in D.P.U. 12-25, the Company issued an RFP for legal services for this rate case. Exh. DPU-1-2(a) Att. (Redacted), p. 1 (RFP dated November 9th.) Responses to the RFP were due by Friday November 30th. *Id*., p. 4. *See also* DPU-1-3(b) Att. (Redacted), p. 9, n. 3 (company "need[s] to move forward with the selection of counsel in order to meet an April Filing deadline . . . ").

Further, Bay State claims that it earned a return of $16.8 million and calculated return on common equity of 6.44 percent during the test year were too low and cites that as the reason that the Department's rates are insufficient. *See* 2012 Annual Return to the Department, Return on Equity For The Twelve Months Ended December 31, 2012, Supplemental Filing Requirements. Tab 1, page 7. The Company claims, however, are not supported by the record.

First, Bay State's income is reduced by the amounts that the NiSource affiliated service and finance corporations have been extracting from the Company. This includes $5 million of above market interest charges from NiSource Finance Corporation. *See* AG Br., p. 3 citing (D.P.U. 12-25, pp. 389-390 (2012)). It also includes $6 million of administrative and general expenses from NiSource Corporate Services Company. Exh. AG-DR-1, pp. 6-8 (direct NCSC costs increased $7.6 million or 33%, and indirect NCSC costs increased $6.5 million or 98% in the last four years). Second, weather during the test year was warmer than normal, thus reducing sales and revenues by over $10 million, further suppressing the annual return on common equity. Exh. CMA/JTG-2, 6/30/13 Update, Sch. JTG-25, p. 9, line 9. Third, annualizing the new base rates that went into effect during the test year increases the Company's revenues by another $11 million.

Exh. CMA/JTG-2, 6/30/13 Update, Sch. JTG-25, p. 9, line 10. Adjusting the test year income for these three factors would mean that the Company should be earning well above is cost of capital, closer to 13.9 percent return on average common equity rather than the 6.44 percent that it claims.[4] This higher effective return demonstrates that the Company is doing quite well.[5]

B. The Department Should Reject the Company's Updates

The Company argues that the Department should allow the June 30 and September 3 updates to its revenue requirement calculations. "A change in statutory law regarding the suspension period requires a change in ratemaking policy by the Department to maintain the adequacy of rate recovery." Co. Br., p. 22. In fact Mr. Bryant demands such an "accommodation" be made for Bay State. Exh. CMA/SHB-1, p. 40. Such an approach represents a patent failure to weigh the interests of the customers in the balancing process of setting rates.

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[4] If one adds up the three factors affecting earnings: expenses of $11 million, weather of $10 million, and rate normalization of $11 million, the total pre-tax effect on earnings is $32 million, and the total after-tax effect is $19.4 million ($32 million x (1 – 0.39225)). This addition to the Company's claimed income of $16.8 million will more than double its income to $36.2 million ($19.4 million + $16.8 million) and its calculated return on common equity to 13.9 percent: [($36.2 / $16.8) x 0.0644].

[5] Bay State Gas claims that its distribution rates for gas distribution services are lower on average than those of the other gas distribution companies in Massachusetts. Co. Br., p. 10. The Company uses Mr. Bryant's analysis of rates that he provided with his Rebuttal testimony in Exhibit CMA/SHB-Rebuttal-5. However, the Department cannot rely on Mr. Bryant's testimony or his analysis of the rates supplied in that exhibit. First, Mr. Bryant did not prepare the exhibit. Tr. I, p. 66 and p. 165 ("Mr. Ferro pulled these numbers"). Second, there were errors in the exhibit which Mr. Bryant could not explain. Tr. I, pp. 163-164. Third, the numbers in the exhibit for each utility were based on each company's own interpretation of what a typical bill was for each class of customers. *Id.*, p. 164-165. There is no standard definition what a "typical customer" uses in each class (e.g. mean, median, mode, or industry standard usage for each class). Indeed, the tremendous variation in the typical usage across the utilities indicates that it is not a reasonable method to do rate comparisons. Exh. CMA/SHB-Rebuttal-5. For instance, the typical usage for the Medium Annual / High Winter class usage varied from 5,582 therms for Boston Gas to 25,356 therms for Colonial Gas (Bay State used 10,351 therms). Equally, the typical Residential Heating class usage varied from 810 therms for Colonial Gas to 974 therms for Boston Gas (Bay State used 966 therms). *Id.* Finally, with varying customer charges, both inclining and declining block usage rates, and the existing cross-class subsidies, Mr. Bryant's rate "comparison" is meaningless.

1. THE COMPANY HAS NOT JUSTIFIED ITS PROPOSAL TO ADJUST ITS RATE BASE FOR NON-REVENUE PRODUCING CAPITAL SPENDING THROUGH JUNE 30, 2013

The Company claims that its proposal to adjust its rate base for non-revenue producing capital spending through June 30, 2013 is "not a movement toward a future test year" and that "the Department's aversion to a 'future test year' is rooted in the need to rely on estimates of future financial results." Co. Br., p. 65. However there can be no dispute that the Company's proposed adjustment is an attempt to move the determination of its rate base beyond the end of the specified historic test year. In that regard, it represents a move towards a future test year, similar to the Company's "rate year/rate base" proposal in D.P.U. 12-25. The Department's rejection of the Company's "rate year/rate base" proposal in that case was based on more than the "need to rely on estimates of future financial results." In particular, the Department noted that "we are not persuaded that the Company's proposal to reconcile the projected revenue requirement at the end of the rate year with the actual revenue requirement warrants a departure from our longstanding precedent." D.P.U. 12-25, p. 20. That longstanding precedent is the use of a historic test year to determine rates. The Company's proposal in the present case is a departure from that precedent and should be rejected.

2. THE DEPARTMENT SHOULD NOT BE MISLED BY BAY STATE'S ATTEMPT TO SUGARCOAT THE NUMEROUS ERRORS IN ITS ADJUSTMENT TO NORMALIZE THE CHARGES FROM NISOURCE CORPORATE SERVICE COMPANY

In its Initial Brief, the Company states that: "the Attorney General's complaint that the Company's computations to normalize the test year charges from NCSC were 'riddled' with numerous errors should also be rejected." Co. Br., p. 102. With regards to the errors, Bay State's Opening Brief also indicates that all of the examples of errors identified by the AGO are "relatively minor adjustments made by a witness who is obsessive in his pursuit of complete accuracy and transparency in his cost of service." *Id*. p. 103.

In its Initial Brief, the AGO identified four different times the Company modified its NiSource Corporate Service Company ("NCSC") normalization adjustment with several of the versions of the adjustment containing revisions that impacted multiple lines in the adjustment. Co. Br., pp. 81-83. These revisions also impacted multiple pages of the back-up workpapers. In fact, for one of the rounds of corrections, the Company's summary of the various corrections and revisions to its workpapers used to calculate the NCSC normalization adjustment ran on for *four and a half pages*. Exh. AG-14-1; Exh. AG-DR-1, pp. 10-11. If more care had been taken in preparing the original adjustment provided with the filing, then perhaps four rounds of revisions to the NCSC normalization adjustment would not have been necessary. The four rounds of revisions and corrections to this adjustment, coupled with the number of changes and corrections made in each round of corrections, seems hardly reflective of a response to an "obsessive" pursuit of "complete accuracy and transparency" as Bay State would have the Department believe. Bay State cannot argue that the numerous errors and revised versions of the NCSC normalization adjustment that it provided did not impact the Department's and the AGO's review of the reasonableness of the resulting normalized costs. Paeans to Mr. Gore's work ethic, which is all that Bay State offers on brief, do not change the reality that the Company's numerous revisions wasted time and undermine the credibility of the latest numbers. Because, ultimately, the Company's extensive corrections beg the question of whether the Department can be confident that the current numbers are now accurate.

The Department should find Bay State's flippant response to AGO's concern with the level of errors and corrections made to this adjustment to be alarming. Bay State states: "[i]f the Department starts penalizing companies by finding 'subpar management' when mistakes are identified and corrected, a very strong disincentive is going to be created to identifying errors in the first place, which is not the results that the Attorney General should be seeking." Co. Br., p. 103. The concern is not simply that an error occurred in Bay State's initial filing and was corrected. The concern is that for one single adjustment, i.e., the NCSC normalization adjustment, the Company needed to correct its calculations and workpapers on four separate occasions with multiple corrections made in several of the versions of the corrections. Bay State improperly suggests in its Brief that a sanction for the excessive number of errors in this case would result in Bay State hiding or burying discovered errors in future proceedings. This suggestion is contrary to the Company's affirmative obligation to keep accurate entries in its books and reports and attest truthfully to the Department as to facts material to its rate request. G.L. c. 166, §§ 80 – 85; *see also* G.L. c. 268, § 6. Therefore, the Department should find that the Company may not make such an argument.[6] The Department should make a specific finding of fact as to the Company's subpar management due to the extent of these errors. A reduction to shareholder earnings as a result would not be a penalty, but rather would

[6] The Department needs to send a clear message to Bay State, just like it did in *Western Massachusetts Electric Company*, D.T.E. 04-40/04-109/05-10. Veiled threats to disadvantage its captive ratepayers are not to be tolerated. Bay State "as the incumbent distribution company, has a public service obligation to represent the best interest of its ratepayers." D.T.E. 04-40/04-109/05-10, p. 6 citing *Boston Edison Company*, D.P.U. 86-71, at 15-16 (1986). The Department should reflect the Company's veiled threat in the return on equity in sets in this case because not much seems to have changed.

be a signal to Bay State's management that it must take more care and including a higher level of accuracy in its future filings as opposed to covering up errors. The burden of proof in supporting its request is on the Company. Included with this burden is the need to provide correct and accurate information with the rate filings. While mistakes may be made that will need to be corrected, the number of mistakes associated with the NCSC normalization adjustment and the number of revisions made thereto goes well beyond an acceptable level of errors.

3. DEPARTMENT SHOULD NOT CHANGE ITS POLICY

Grossed up for uncollectible accounts, the total revenue requirement effect of the Company's proposed adjustment is $3,577,962. However, the Company does not include incremental revenues from new business in the calculation of its revenue deficiency which would mitigate the increase, and if accepted, would cause a mismatch between the plant included in rate base and the benefits produced by that plant. Exh. AG-DJE-1, at 26. The inclusion of the NIFIT system illustrates the nature of this mismatch. Bay State has not proposed any pro forma adjustment to recognize the benefits that it claims are associated with the NIFIT system. It would be inconsistent to adjust rate base to include these post test year additions without any adjustment to recognize new customers and the expected savings that result from these systems. *Cf. Boston Gas Company*, D.P.U. 93-60, pp. 39-40 (1993) (known and measurable savings credited to customers.).[7]

[7] Improvements in technology and productivity that reasonably may be anticipated between the test year and the first twelve months in which new rates are in effect, and which demonstrate a decrease in residual O&M expense as known and measurable amounts, should be taken into consideration in setting rates. *Massachusetts Electric Company*, D.P.U. 92-78, pp. 47-48 (1992); *Commonwealth Electric Company*, D.P.U. 89-114/90-331/ 91-80, Phase I, p. 160 (1991).

Since Bay State has not reflected either new customers or savings in its updates, it's claimed "attrition" has not been established. The Department cannot require customers to bear the burden of the proposed updates without receiving and appropriate share of the benefits. If the Department is going to move to a future test year, it must not only include post test year capital additions but post test year savings.

Bay State also argues that its post test year updates are justified because that is what the Department did in the 1970s, the last time the suspension period was 10 months. However, a lot has changed since the 1970s. Bay State has a lot more "attrition" adjustments today than in the 1970s. Back then, Bay State had a Cost of Gas Adjustment ("CGA") to prevent "attrition." Today, it has *ten more* adjustment clauses than it did in the 1970s, many of which provide for dollar for dollar recovery of costs that were included in base rates in the 1970s. *See Bay State Gas Company*, D.P.U. 12-126 (January 22, 2013 filing). If the Department wants to return to 1970s rate regulation, then it truly to do so properly, it must eliminate all the "attrition" adjustments except for the CGA.

Based on the record in this case, the Company's update arguments are irrelevant. Bay State is going to file a rate case next year regardless of whether the test year is updated.

C. Distribution System Integrity Management Program and Capital Plans

The AGO has spotlighted aspects of Bay State's capital program meriting close scrutiny by the Department (AG Br., pp. 22-30). The Company has responded by adding considerable hyperbole[8] to its brief on this topic in an attempt to distract the Department from two very important arguments made the AGO in its initial brief: 1) the Company has provided no analysis justifying the ramped-up level of DIMP-related capital expenditures recovered by the TIRF under its modernization plans (Co. Br., pp. 22-24), and 2) the Company has provided no analysis supporting the level of excess system capacity it concedes is built into its capital program. Co. Br., pp. 24-36. As explained below, the Company on brief has been unable to rebut the Attorney General's arguments.

1. LEAST COST PLANNING AND THE DIMP

The Company seems to agree with the AGO that the Distribution System Integrity Management Program ("DIMP") regulations do not mandate any particular level of spending or changes in capital plans, (Co. Br., pp. 23) but then goes on to paraphrase the regulations in support of its own proposal, which contains a very specific time period for the "accelerated" removal of certain leak prone facilities from part of its system. *Id*. Quoting just parts of the AGO's brief that suit its argument, the Company notes in support of its planned capital expenditures that the DIMP regulations require it to:

> (5) **begin implementing the measures to reduce risk or have a plan to implement measures to reduce risk which includes an implementation schedule**. 49 C.F.R. § 192.1007 (emphasis added).

Co. Br., p. 23. The problem here is that the quoted language appears nowhere in the Pipeline and Hazardous Materials Safety Administration ("PHMSA") regulations (including the referenced 49 C.F.R. § 192.1007), although the Company cites to both the

[8] Among its grousing, the Company derides the AGO's arguments as "nonsensical" and not "intelligent." Co. Br., p. 23. If derision substituted for fact in a Chapter 30A investigation, the Company would have a winning argument.

Code of Federal Regulation and uses the "emphasis added" citation format to make it appear so. The Company is really just referencing a few of the DIMP plan elements as analyzed by the Attorney General in her brief while dismissing critical others, including: "[The PHMSA regulations] did not require any specific changes to operations, maintenance, or investments." AG Br., p. 14. Claims that ramped up spending of the type proposed in the modernization plan, or even what the Company believes is the DIMP-inspired portion of it, are simply not expressly required by the PHMSA or supported by the Company with any type of analysis connecting the lessons learned from the DIMP with the capital plan discussed in the filing.

2. PHSMA REGULATIONS DO NOT OVERRIDE STATE RATEMAKING

The Company argues that no analysis is necessary connecting its expenditures to the DIMP, and that the DIMP simply requires more and more spending without any regard to traditional ratemaking concepts, like least cost planning:

> However, the concept of justifying TIRF-related investment with the DIMP and with **a cost-benefit analysis is an internally inconsistent request**. Under DIMP, there is no consideration of cost – DIMP operates on the concept of risk reduction.

Co. Br., pp. 23-24 (emphasis added). There is nothing "internally inconsistent" with using cost benefit analysis to select the most efficient means to accomplish any utility goals, including those related to safety. The PHSMA regulations do not override the Department's ratemaking authority, and it has a duty to ensure that the Company provides both safe and reliable service at just and reasonable rates. When has the Department ever endorsed spending without limit in the cost of service?

The PHSMA regulations do require that Bay State "[i]dentify and implement measures to address risks," 49 C.F.R. § 192.1007(d), but do not specify the remedies of methods the Company uses. It could very well be that after the self-review required by the DIMP, the Company found its existing practices and strategies allowed it to operate a safe and reliable system and that no changes were necessary.[9] Alternatively, the Company could have determined that it could improve certain operating procedures to improve safety, like enhanced programs for municipal outreach and roadwork contractor education to avoid dig-ins as a way to mitigate risk to all underground facilities at a fraction of the tens of millions of dollars the Company plans to spend on "accelerated" replacement of leak-prone pipe. Why spend millions more on "accelerated" replacement if better procedures could reduce public safety risks from dig-ins at a fraction of the cost to customers? The DIMP process might have revealed that more frequent winter leak surveys in areas where "leak prone" pipes were located could help the Company improve public safety and reduced Green House Gas ("GHG") emissions by proactively identifying and repairing leaks at a much lower cost than "accelerated" pipe replacement. Maybe some combination of these measures, and many others unexplored in the initial filing by the Company, would have provided public safety and environmental benefits at a lower cost to customers. The Company did not discuss any such analysis and improperly argues it need not do any before ramping up spending because of the DIMP.

[9] It could have hardly come as a big surprise to the Company after the DIMP review that it had cast iron pipe in the ground, and needed to take certain steps to manage that infrastructure. To the extent that the Company really believes more spending is needed in light of the DIMP, that suggests the Bay State previous practices have been deficient.

3. THE COMPANY CANNOT RELY ON EVIDENCE FROM D.P.U. 12-25

Although the Company now endorses the recommendation of Dr. Dismukes from the last rate case regarding levels of pipe and main replacement activity, (Co. Br., p. 24, citing Exh. AG/DED-1, pp. 3-4 from D.P.U. 12-25), in this proceeding the Company sought to help support its increased level of capital expenditures based on the "administration of DIMP requir[ing] a ramp-up in capital replacement." Exh. CMA/DEM-1, p. 23. It did not seek to support its TIRF or modernization program based on the opinions of Dr. Dismukes from the previous rate case, which, of course, forms no part of the evidentiary record in the present matter. It is too late for the first time on brief for the Company to say, in effective, that it is abandoning its own DIMP in favor of Dr. Dismukes. In any event, nothing in the order in D.P.U. 12-25 states that Dr. Dismukes analyzed the DIMP when he made recommendations in the last rate case or that it was even part of the record. That the Company itself did not provide analysis linking its level of capital activity with the DIMP is a failing of the Company in last rate case as well as this one.

4. FINAL RECOMMENDATION

The PHSMA regulations do not require that the Company adopt the most expensive solutions to identified risks, but that would be a path permitted under the Company's line of reasoning that a cost benefit analysis is "internally inconsistent" with the DIMP. The Department must reject "at any cost" planning. Although the Department would be justified in rejecting cost recovery for the ramp-up level of capital expenditures on these grounds, the Department may adopt a more modest remedy. The Department should require the Company to submit a cost-benefit analysis with a robust range of alternative operations, maintenance and capital investment solutions to the DIMP identified risks with its next base rate case, and with its annual capital cost recovery filings, if those are permitted to continue. AG Br., p. 17.

D. Excess System Capacity and Intergenerational Equity

Next, the Company argues for several pages that the Attorney General has made an “equally confused argument” focusing on the fact that the Company has offered no analysis to support the level of excess system capacity built for future use. Co. Br., pp. 25-31. Missed among the pages of jargon discussing differences between peak day, design day and the physical distribution system is the fact that the Company has not provided analysis to justify the level of excess system capacity in has built into the system, or in the Company’s own words, pipe installations that “allow for a measure of growth.” Co. Br., p. 25. As the AGO explained in its Initial Brief (AG Br., pp. 17-26), it is precisely the lack of analysis and quantification of the “measure of growth” that is the flaw in the Company’s proposal for permission to overbuild its system. Furthermore, allocating 100% of excess system capacity costs to present customers creates intergenerational equity problems. Under the Company’s approach, there is no limit to the unneeded capacity in the “measure of growth” that present customers must be forced to pay for the benefit of future customers that may, or may not, take service someday. Certainly, no reviewing court would approve of this allocation scheme based on the record. Although the Company has not adequately rebutted the AGO’s arguments, despite its colorful rhetoric, there are a few issues raised which merit a brief response for clarity, as follows.

1. THE COMPANY'S CITED REFERENCE TO D.P.U. 12-25 ON SYSTEM CAPACITY DOES NOT EXIST IN THE ORDER

To support its claim that an unspecific and apparently unlimited "measure of growth" has already been approved by the Department for the TIRF, the Company offers this argument:

> The Department has already found that it would be imprudent if the Company did not consider the capacity needs of the system at the time of replacement, which is an appropriate finding given that the pipe that the Company is installing is expected to have a useful life in excess of 50 years, so that sizing pipe to meet system needs within a five-year planning horizon is essentially crafting capacity to current requirements. D.P.U. 12-25, at 80.

Co. Br., p. 25. The problem here is page 80 of D.P.U. 12-25 does not actually say that. All page 80 states on the issue of future capacity needs is "[i]t stands to reason that it would be imprudent if the Company did not consider the capacity needs of the system at the time of replacement." Nowhere does the Department state that "a five-year planning horizon is essentially crafting capacity to current requirements" or anything like that. The Department's guidance is far more modest and precise than the Company's characterization of it, and it is flexible enough to account for times of rising, as well as falling, anticipated demand. The Company's interpretation would make no sense if load were expected to contract, for example, as building a system now for a predicted future drop in needs five years out may result in near term reliability problems. The Department requires consideration of future needs at the time of replacement; it did not preapprove unending growth.

Critical to the amount of capacity the Company should build – and lacking in this record is an analysis of future and present distribution system capacity needs in particular service areas, and not vague, open-ended rules of thumb applied system-wide. The Company makes belated attempts to discuss some of these matters on brief, but most of the assertions of "fact" are without citation to the record, (for example, see Co. Br., pp. 26-27), and the Department cannot rely on them to support a decision. The Company had ample opportunity to put this information on the record via redirect examination of its own witnesses during hearings, but did not. It should not be permitted now essentially to make its points by "testifying on brief" after the close of the record.

The Company has three separate service areas with different system configurations, and the Company has offered no analysis at all to support the anticipated amount of excess system capacity each distinct area might need in the near, medium, or long term. What level of expected new customer load is being planned for in each operating division, over what time horizon is the load expected to arrive, and what happens to cost recovery if those customers never materialize? None of these questions are even asked by the Company in relation to distribution system capacity, much less answered. The order in D.P.U. 12-25 did not give the Company a blank check to force today's customers to pay for an unlimited amount of excess capacity for future customers, but that is the authority the Company claims the Department granted it.

2. THE AGO'S SITE VISIT AND THE SYNERGEE MODEL REPORTS

The Company argues that the Attorney General's Office ignored evidence from a site visit to inspect the Company's SynerGEE model. Co. Br., pp. 29-30. There is no citation to the record for this claim (Co. Br., p. 30, n. 8), nor could there be because that is not on the record. The Department should disregard this assertion of "fact" and any imagined system "reports" that supposedly were shared at that time. The Company may not simply assert whatever facts it needs on brief without regard to what it saw fit to put into the record in the first place. While the case was in discovery or evidentiary hearings, if the Company felt it necessary to put the AGO's witness knowledge of the SynerGEE system on the record, it could have easily done so by cross examination during the September hearings. Of course, the Company declined to do so. Perhaps because the Company was apprehensive about what the AGO's witness might say on the stand. It is now unavailing for the Company to imply that the long-sought-after pre-and-post pipe replacement network analysis reports on physical delivery capacity were perhaps revealed during a site meeting, but ignored by the AGO's expert. The Company advances such an argument this way: "However, the Attorney General has ignored all of this evidence, and therefore, the ***alleged lack*** of additional reports is a spurious claim." Co. Br., p. 30 (emphasis added). The ***actual lack*** of these additional reports in the record is conclusively proven by Company's response to Exh. AG 21-12, and no finger pointing to a site visit that is not on the record can change that very stubborn fact. The reviewable record is clear that the Company says it conducts this analysis for each segment, as it must, but does not retain these records:

AG-21-12: Please provide a copy of the Distribution System Network Analyses by service area before and after the replacement of the segments of main listed in response to AG 21-8 & 9, above.

Response: The Company maintains models of its distribution system that include all changes to its system, both physical and demand-related (customer changes). Using this approach, the Company is able to review all changes to its system and make decisions to maintain a reliable system to supply its customers at design conditions. The Company uses these models when evaluating the main size for segments listed in response to Information Requests AG-21-8 and AG-21-9. However, the change of the system performance over time is the result of many changes other than the projects referenced in the Company's responses to Information Requests AG-21-8 and AG-21-9. Previous versions of the model subsequent to each project change are not retained.

Exh. AG 21-12. The Department should reject any insinuation that the needed reports were somehow provided for review in a site visit but later ignored.

3. THE COMPANY NEVER UPDATED THE TRANSCRIPTS FOR ALLEGED CORRECTIONS TO SYSTEM CAPACITY TESTIMONY GIVEN "SUBJECT TO CHECK"

The Company claims that its gas engineering witness corrected the record for an answer given "subject to check" in hearings regarding the amount of extra capacity the Company builds into its system as a rule of thumb during capital projects, or "growth rate" as the Company calls it. Co. Br., p. 29. The Company testified that the rate was 3%. Tr. Vol. II, p. 254. There were numerous questions on the record regarding system capacity issues, including the ability to measure deliverability of gas across the operating divisions, TIRF uprating, and capacity planning. Tr. Vol. II, pp. 244-246 ("pressure on our system . . . that's really kind of an inferred definition of capacity on our system"), 248, 254-257. While the Company complained that the Attorney General improperly "conflated" supply concepts and physical delivery capacity (Co. Br., p. 25), it was the

Company that claimed it did not know the limit of physical delivery capability across its operating divisions, Tr. Vol. II, pp. 245-245, and took a position melding the concepts of adequate supply with system capacity:

> Again, the capabilities of delivering gas is really inferred through the ability to deliver gas to the customer at the furthest reaches of our system and still maintain service.

Tr. Vol. II, pp. 248. Having established the framework linking these two concepts under oath, the Company should not be entitled now to change its position on brief by arguing that system growth figures really have nothing to do with the amount of physical capacity designed into the system during pipe replacement projects. The Company cannot have it both ways. In any event, after the hearings, the Company did not seek via a motion to correct the transcript for any of the testimony offered. If the Company's "check" resulted in a different answer for its witness on capacity issues, then the Company was obligated to correct the transcript via a motion so that parties could seek additional cross examination if the new answer prompted more questions. None was filed.

Instead, the Company argues that the answer to RR-AG-4 revised the testimony. The complete question and answer reads as follows:

Record Request AG-4 (Tr. 2, at 250-5)

> Referring to the chart that accompanies the response to Information Request AG-16-9, please explain how the Company derived the three percent per year growth growth assumption included for this response.

Response:

> The customer growth rate, as filed in the Company's currently pending Forecast and Supply Plan ("F&SP") filed in D.P.U. 13-161, is 1.2 percent for the overall system. For system replacement purposes, the Company takes a more conservative approach and a higher growth rate of three percent is used to prioritize competing projects to account for growth in portions of the system that also have known reliability issues or are nearing operating levels where reliability issues are likely to exist over a five-year planning horizon.

The record request simply asks for the source of the 3% figure. The Company answers by stating that the source of the current 1.2% growth figure is from the pending (and not approved) forecast and supply plan recently filed in D.P.U. 13-161, and does not reference the currently approved and lower forecast figure from D.P.U. 11-89 (2012) that would have been applicable to the 2012 test year capital activities. There is, however, no analysis at all supporting the 3% figure that is used for "system replacement purposes" (in other words TIRF projects) other than it is "conservative." Why is a figure more than double the currently proposed five-year growth rate "conservative," and not 2% or perhaps 5% or even 10%? The Company appears to have pulled this figure out of thin air, and that does not constitute substantial evidence. A reviewing court will certainly agree. *See, e.g. Boston Gas Company v .Department of Public Utilities,* 436 Mass. 233, 240-242 (2002) (accumulated inefficiencies value requires direct quantitative evidence).

4. FINAL RECOMMENDATION ON EXCESS SYSTEM CAPACITY

The record lacks any evidence to determine what amount of excess system capacity may be reasonably built in anticipation of load growth or system expansion. [10] Even if the Company did produce the needed analysis, it has offered not a scintilla of evidence or even argument to support allocation of 100% of that excess system capacity to current customers. The Department must exclude excess capacity from rate base either through a subsequent investigation to examine the amount of excess capacity that should be deducted from rate base or as a new variable added to the TIRF mechanism to reduced excess capacity from rate base in annual filings. AG Br., p. 26.

E. Targeted Infrastructure Recovery Factor

1. THE DEPARTMENT SHOULD REJECT BAY STATE'S PROPOSED MODIFICATION TO THE EXISTING RATE IMPACT CAP

a) The Company's Claimed Reason for a Change to the Existing Rate Impact Cap Is Not Supported by Facts in the Record

In its Brief, the Company attempts to rewrite the history of the TIRF's rate impact cap by positing arguments that are supported by neither the facts nor the law. In particular, the Company argues as follows:

> the existing cap was proposed by the Company in D.P.U. 09-30 based on the Company's understanding and belief that (1) the cap would apply only to the replacement of non-cathodically protected steel facilities; (2) the Company would retain the flexibility to determine the annual number of miles of main replacement so as to stay under the cap; and (3) gas prices would remain sufficiently constant over time to result in an adequate and reasonably predictable cap level.

[10] The Attorney General has made an argument to exclude the capital additions listed in Exh. AG 21-8 and Exh. AG 21-9 from rate base for a failure to demonstrate prudence, (AG Br., p. 20), and the argument concerning excess system capacity is a related but separate issue. AG Br., p. 26.

Co. Br., pp. 32-33. The Company's contention that these three elements comprise some kind of material adverse change that requires an increase in the rate impact cap is baseless and should be rejected by the Department.

First, the Company's argument that the Department's decision in D.P.U. 12-25 to include small diameter cast-iron and wrought iron mains within the TIRF necessitates an increase in the rate impact cap is flawed, because it ignores that this modification was a proposal of the Company, which at the time, did not propose any corresponding increase in the cap. AG Br., p. 36 and *Bay State Gas Company*, D.P.U. 12-25, p. 26. Indeed, in D.P.U. 12-25 the Company requested cost recovery for replacement of all cast iron mains less than 12 inches in diameter, a threshold greater than that approved for other gas utilities in the Commonwealth. AG Br., p. 37 and D.P.U. 12-25, p. 49. Throughout the adjudication of D.P.U. 12-25, Bay State continually has the opportunity to propose to modify its existing rate impact cap. In fact, one of the few references to the rate impact cap in D.P.U. 12-25 explicitly stated that "the Company *is not proposing to change the one percent cap* for the Modified TIRF, with the inclusion of cast-iron infrastructure." Exh. AG/DED-1, p. 26 (emphasis added). If the inclusion of small diameter cast-iron and wrought-iron mains is the reason for the need to modify the TIRF rate impact cap, D.P.U. 12-25 would have been the appropriate venue to address this issue. The Department was adequately positioned in D.P.U. 12-25 to weigh the benefits of accelerated replacement of cast-iron and wrought-iron mains with the reduced ratepayer protections needed to allow the Company appropriate flexibility. Therefore, the Company's argument that the "existing cap was proposed by the Company in D.P.U. 09-30 based on the Company's understanding and belief that (1) the cap would apply only to the replacement of non-cathodically protected steel facilities" is only half-true because it neglects to address the fact that the Company expressly declined to seek to raise the cap when it sought to expand the TIRF's eligible facilities in DPU 12-25.

Second, the Company's suggestion that the Department's "mandate" of a 38 mile annual replacement rate requires the modification of the existing TIRF rate impact cap is similarly misleading. The Department imposed no such mandate, but rather set a threshold replacement level of 38 miles given Bay State's "poor" pipeline replacement performance in the three years following its TIRF adoption. AG Br., p. 37 and D.P.U. 12-25, p. 53. The Department determined that 38 miles was an appropriate threshold based on Bay State's average annual replacement rate for the years 2007 through 2011, a period that includes years (2007-2009) during which the Company was operating without a TIRF. AG Br., pp. 37-38 and D.P.U. 12-25, p. 54. Furthermore, the evidence in the record shows that 38 miles is far below the 53 to 70 mile annual replacement rate the Company would need to achieve in order to replace its entire leak-prone infrastructure in the Company's time-frame of 15 to 20 years. Tr. Vol. I, pp. 105-107. Therefore, the Company's argument that the Department's 38-mile threshold somehow necessitates an increase in the rate impact cap is a non-sequitur and should be disregarded by the Department.

Lastly, the Company's contention that the volatility of post-2009 natural gas prices further necessitate an increase in the TIRF rate impact cap ignores the fact that the Company's prior proposal to modify elements of the TIRF in D.P.U. 12-25 was argued a full four years after natural gas commodity prices had fallen from their all-time highs. Exh.AG/DED-1, p. 27. As with the Company's argument regarding TIRF expansion, if this was truly a sufficient reason for the Company's proposed modification, D.P.U. 12-25 would have again been the appropriate venue to address this issue. The fact that the Company is only marshaling this argument now suggests it is merely a last ditch effort wring more money out of the TIRF mechanism. Ultimately, while the Company may want to increase the TIRF rate impact cap, its arguments that the current cap is outdated and needs to be changed to account for material changes in the regulatory environment or natural gas market is inaccurate.

b) Arguments That the Proposed Change to the Rate Impact Cap Is Needed to Create A Predictable Level of Recovery Through the TIRF Ignores the Flexibility Inherent Within the Existing Rate Impact Cap

Bay State argues that its proposed change to the rate impact cap is needed to "create a predictable level of recovery through the TIRF." Co. Br, p. 34. Specifically, the Company argues that if its proposed 3.75 percent cap on base rate distribution revenues is applied to 2012 test year distribution revenues, it results in approximately $6.63 million; an amount roughly equivalent to the cap established in D.P.U. 09-30. This, the Company suggests, brings the level of the cap back to that recommended by the Company and approved by the Department in D.P.U. 09-30. Co. Br., p 34. The Company's argument here ignores the significant flexibility inherent within the existing rate impact cap. Indeed, the record shows that Bay State failed to demonstrate that the Company's existing rate impact cap based on 1 percent of total revenues is insufficient to allow the Company adequate flexibility in its future infrastructure replacement plans.

Dr. Dismukes has shown that the Company has historically invested far less in pipeline replacement than allowed under the existing one percent rate impact cap. Exh. AG/DED-1, pp.19-20; and Exh. AG/DED-1, Schedule DED-3. In fact, Dr. Dismukes found that Bay State had only averaged annual investments equal to 56.9 percent of that allowable under the existing rate impact cap. *Id*. He further demonstrated that, going forward, the current rate impact cap is not likely to be an investment constraint on the Company for two reasons. First, Bay State's base distribution revenues have been growing at an average annual rate of over four percent for the past three years, with shares of total revenue increasing from 21 percent of the Company's total revenues to over 45 percent during the same time-frame. Exh. AG/DED-1, p. 20; and Exh.t AG/DED-1, Schedule DED-4. Second, independent analysis from the Energy Information Administration ("EIA") projects natural gas commodity prices to increase by an inflation-adjusted annual average of nearly two percent through 2028, likely leading to increases in commodity revenues for the Company. Exh. AG/DED-1, p. 21. In short, Dr. Dismukes estimates that there will be considerable headroom over the next eight years between anticipated TIRF investments and the maximum allowable investments under the existing one percent rate impact cap. Exhibit AG/DED-1, p. 23; and Exhibit AG/DED-1, Schedule DED-8.

Instead of presenting its own evidence for the record, the Company attempts to justify its proposed modification by attempting to cast doubt on Dr. Dismukes' findings and distorting evidence in the record. First, the Company claims that Dr. Dismukes testified that it is "possible that customers would be better off with a cap tied exclusively to distribution revenues." Co. Br., p. 43, citing Tr. Vol. XII, pp. 1177-1178. Contrary to the Company's claims, Dr. Dismukes did not make this statement. Instead, he testified that it is "possible that customers **could** be better off with a cap that is tied just to base revenues." *Id*., pp. 1177-1178 (emphasis added). Moreover, the record shows that here

Dr. Dismukes was commenting on the "conceptual" possibility that, in a hypothetical situation where natural gas prices increase, the Company's existing rate impact cap may allow the Company to spend more on the TIRF than the proposed modified cap. Tr. XII, pp. 1177-1178. As shown by Dr. Dismukes, independent analysis from the EIA projects natural gas commodity prices to increase by an inflation-adjusted annual average of nearly two percent through 2028, but hold "to relatively moderate overall levels of no more than $8.12 by 2028." Exh. AG/DED-1, p. 21. Using this independent analysis, Dr. Dismukes found that the Company's proposed rate impact cap modification provided a more generous cap for the Company through at least 2017. Exh. AG/DED-1, Schedules DED-8 and DED-9.

Further, the Company claims that Dr. Dismukes' analysis showing significant flexibility in the existing rate impact cap is flawed because "[Dr. Dismukes] used a revenue requirement of only $3.4 million in [his] analyses, which significantly understates TIRF recovery since the total is based on only 25 miles of replacement." Co. Br., p. 43, citing Tr. XII, pp. 1166-1167, 1177-1178, and 1179-1181. This attempt to cast doubt on Dr. Dismukes' analysis should be rejected by the Department. The Company ignores the substantial miles of mains, 57.1 miles in all, included within Dr. Dismukes' projections. Exh. AG/DED-1, Schedule DED-11. Therefore, Dr. Dismukes' analysis accounted for the Company replacing a total of 82.1 miles of pipe per year. Even after accounting for the Department's threshold of 38 miles of main replacement per year, Dr. Dismukes' analysis assumes 44.1 additional miles of mains replaced per year, more service replacements than the Company has performed in any year under the TIRF prior to 2012. Exh. AG/DED-1, Schedule DED-11.

c) The Company's Statement That the Proposed Modification Does Not Undermine the Effectiveness of the Cap In Limiting Bill Impacts Should Be Rejected

Bay State claims it has demonstrated that a decision to fix the rate impact cap at 3.75 percent of base revenues will not undermine the effectiveness of the cap in limiting bill impacts to customers. Co. Br., p. 35. The Department should reject this argument. As Mr. Bryant noted at the evidentiary hearing, it is more important from a customer perspective to mitigate impacts to total utility bills than just the distribution part of a bill. Tr. Vol. I, p. 96. The Company's proposed modification moves the rate impact cap away from protecting customers from increases to total utility bills due to the TIRF and directs towards only protecting customers from substantial increase to distribution rates. Furthermore, the Company incorrectly attempts to compare the per-customer cap of its proposed modification to a per-customer valuation of the existing total revenue-based cap in D.P.U. 09-30. Co. Br., p. 35. As shown by Dr. Dismukes, the Company's proposed modification would have allowed larger rate impacts to customers from 2010-2012. Exh. AG/DED-1, Schedules DED-3 and DED-9. In particular, in 2012, a modified TIRF would have permitted the Company to increase its TIRF-related revenue requirement by over $1.5 million dollars or over 30 percent. Exh. AG/DED-1, Schedules DED-3 and DED-9.

d) DOER's Argument That the Company's Proposed Modification of the Existing Rate Impact Cap Is Superior to the Existing Cap Is Inaccurate and Ignores Facts in the Record

DOER makes three arguments supporting the Company's proposed change to its existing rate impact cap. First, DOER argues that calculating a cap based on base distribution revenues best meets the principal purpose of mitigating bill impacts and rate continuity. DOER Br., pp. 4-5. Second, DOER argues that calculating a cap based on base distribution revenues best promotes the goals of efficiency and reasonable cost. *Id.*, pp. 5-6. Finally, DOER argues that the Department's 38-mile minimum threshold requires a more stable cap. Id., p.6. All of DOER's arguments are inaccurate, unsubstantiated, and should be rejected by the Department.

First, DOER's argument that the proposed rate cap modification better mitigates bill impacts and establishes rate continuity ignores the facts in the record that it is more important from a customer perspective to mitigate impacts to total utility bills than just the distribution part of a bill. Tr. Vol. I, p. 96. As stated previously, the Company's proposed modification moves the rate impact cap away from protecting customers from increases to total utility bills due to the TIRF and orients it towards only protecting customers from substantial increases to distribution rates. DOER has presented no evidence contradicting this position.

DOER's second and third arguments stress that the proposed rate cap modification will add efficiency and stability to the functioning of the TIRF, which it suggests is particularly necessary in light of the Department's recently imposed 38-mile minimum threshold. DOER Br., pp. 5-6. The concept, proffered by the Company and echoed by DOER, that the TIRF's current rate impact cap is too erratic to promote efficient infrastructure replacement is flawed. Revising the rate impact cap is unnecessary. As shown by Dr. Dismukes, going forward, the current rate impact cap is not likely to be an investment constraint on the Company. AG Br., p. 33; Exh. AG/DED-1, pp. 20-21; and Exh. AG/DED-1, Schedule DED-4. Neither DOER nor the Company has presented any evidence contradicting Dr. Dismukes' analysis.

In its Brief, DOER states that it "strongly agrees with the Department that there are significant public safety, economic, and environmental benefits associated with replacing leak-prone pipe." DOER Br, p. 1. However, DOER's recommendation to modify the cap will not help effectuate any of the "public safety, economic, and environmental benefits" the TIRF was designed to achieve. As facts in the record show, the proposed modification of the existing rate impact cap is not needed to sustain an adequate level of infrastructure replacements in the future. Exh. AG/DED-1, pp. 20-21; and Exh. AG/DED-1, Schedule DED-4. Therefore, in the end, DOER's recommendation simply costs ratepayers more money while providing no benefits to any party, except Bay State shareholders. A better way for the Department to promote public safety, economic, and environmental benefits associated with replacing leak-prone pipe would be for the Department to adopt a leak-based performance metric, similar to the mechanism the AGO proposes in Section II.E.2.5 of this Brief. Exh. AG/DED-1, pp. 71-72; *Bay State Gas Company*, D.P.U. 09-30, pp. 133-134; and *Bay State Gas Company*, D.P.U. 12-25, pp. 34-35. Ultimately, the Department should reject DOER's misguided argument that the Company's proposed modification of the existing rate impact cap is superior to the existing cap as it ignores facts in the record suggesting such a change is not in the best interests of ratepayers and unnecessary. In the alternative, the Department should establish a leak-based performance metric that will ensure that the TIRF provides the public benefits to ratepayers the program was originally designed to deliver.

2. THE DEPARTMENT SHOULD REJECT BAY STATE'S PROPOSED DEFERRED IN-SERVICE COSTS

a) Company's DISC Proposal Is Inconsistent With Prior Department Policy

The Company argues that AGO's objection to the Company's Deferred In-Service Costs ("DISC") on the grounds that the Department has previously rejected proposals with carrying costs is meaningless. Specifically, Bay State states that "there is no bar that prohibits a company from making a proposal to the Department that has been made in the past." Co. Br., p. 44. It adds that "the mere fact that the Department has denied recovery of a particular cost in the past is not proof that it should be denied in the future." *Id*., p. 45.

While both of the Company's statements are true, the Company conveniently ignores the significance that the exclusion of carrying costs played in the Department's approval of the TIRF, which only came after it had twice rejected a similar Steel Infrastructure Replacement ("SIR") rider in D.T.E. 05-27 and D.P.U. 07-89. AG Br., p 42, *citing Bay State Gas Company*, D.T.E. 05-27 (2005); *Bay State Gas Company, D.P.U.* 07-89 (2008). In both proceedings, the Department rejected the Company's proposed infrastructure cost recovery rider for a number of reasons, including that the mechanism was unnecessary because the Company's proposed rate of replacement was consistent with historic replacement rates, and thus could not be defined as accelerated. AG Br., p. 42, *citing Bay State Gas Company*, D.T.E. 05-27, pp. 46-49; *Bay State Gas Company*, D.P.U. 07-89, pp. 43-44. However, as a means of presenting the TIRF as more palatable than the prior SIR proposals, Bay State dropped the carrying costs component from its TIRF proposal and touted its exclusion by specifically noting that, "[t]his [removal of carrying costs] represents a substantial modification to earlier proposals and imposes 100% of the financing cost burden during this interval (10 to 22 months) on Bay State." Exh. AG/DED-1, p. 55. Bay State has presented no evidence that a different standard or reasoning should be used in this case.

In approving the TIRF, the Department rejected an argument by the AGO and the United Steelworkers of America that the proposal was essentially no different than the prior SIR mechanisms rejected by the Department in D.T.E. 05-27 and D.P.U. 07-89. AG Br., p. 42, *citing Bay State Gas Company*, D.P.U. 09-30, pp. 129-130. The Department noted that the TIRF possessed three "significant differences" with prior SIR proposals, one of which was the omission of a carrying cost component. AG Br., p. 42, *citing Bay State Gas Company*, D.P.U. 09-30, p. 130.

The Company references the Department's finding in D.P.U. 09-30 that circumstances had changed considerably from previous cases wherein the Department rejected the SIR as support for its position. Co. Br, pp. 44-45, *citing Bay State Gas Company*, D.P.U. 09-30, p. 131. Specifically, in D.P.U. 09-30, the Department noted that its decision to terminate the Company's then-existing performance-based ratemaking ("PBR") mechanism constituted a significant change in the Company's regulatory framework. D.P.U. 09-30, p. 131. The Company, however, makes no argument as to what material factor warrants the Department reconsidering how it views a carrying charge vis-à-vis the TIRF mechanism. Clearly, if there is some reason why a carrying charge in context of a TIRF mechanism should be more palatable to the Department now than it was a few years ago, Bay State has not articulated it. Instead, the Company's argument boils down to a statement of its right to propose ratemaking treatments, regardless of whether the Department has previously considered and rejected them.

Theoretically, the Company is able to propose whatever it wants. More importantly, though, it has failed to present convincing evidence that the Department should change its precedent; thus, the Department should reject the Company's DISC proposal as inconsistent with its prior findings in D.T.E. 05-27, D.P.U. 07-89, and D.P.U. 09-30.

b) Company's DISC Proposal Circumvents the Disciplining Role of Regulatory Lag

The Company argues that the AGO's statement of the importance of regulatory lag "fails to acknowledge that the Department's responsibility to set rates so as to allow a utility the opportunity to earn a fair return on its investment takes precedence over regulatory lag." Co. Br, p. 45. The Company here confuses the Department's responsibility to allow a utility the opportunity to earn a fair return on investment with a claim that it has a responsibility to actually guarantee that a utility earns its allowed return on investment. The Department itself has noted in previous orders that special ratemaking mechanisms such as the TIRF are "not intended to provide an all-out financial support for a specifically established term and program of mains replacement ***nor supplant or eliminate the disciplining role of regulatory lag inherent in traditional ratemaking principles***." *Boston Gas Company*, D.P.U. 10-55, pp. 132-133, (emphasis added). The Department should reject the Company's argument against regulatory lag as misguided. Indeed, taken to its logical conclusion, the Company's line of argument would, contrary to the Department's stated desire, "eliminate the disciplining role of regulatory lag."

c) The Department Should Reject DOER's Assertion That the Company's DISC Request Is Reasonable

DOER's arguments supporting the Company's DISC request seem based on a belief that circumstances have materially changed subsequent to the Company's initial TIRF proposal in D.P.U. 09-30 foregoing carrying costs. First, DOER argues that carrying costs have increased from $1-1.4 million in the first two years of the TIRF to almost $4 million by 2013. DOER Br., pp. 8-9. Second, DOER argues that the TIRF now includes the Department's 38-mile minimum replacement threshold and the inclusion of cast iron and wrought iron main 12 inches in diameter or less. *Id.*, p. 10. Regarding the first contention, DOER fails to note that the Company expects to replace 47 miles of main in 2013, compared with only 16 and 12 miles of main replaced in 2009 and 2010, respectively.[11] DOER Br., p. 6; Exh. AG/DED-1, Schedule DED-11. This equates to an increase of over 235 percent and is completely in line with carrying costs increasing from $1-1.4 million in 2009 and 2010 to nearly $4 million in 2013.

Next, DOER's claims that the Department's 38-mile threshold and expansion of eligible facilities under the TIRF constitute a material change in circumstances are similarly invalid. As has been noted *supra*, the Department's 38-mile minimum threshold was an effort by the Department to ensure that the TIRF was delivering the public benefits the mechanism was designed to provide. Therefore, that the Company would have been replacing at least this level of infrastructure should be been known at the time the Company's proposed the TIRF without carrying costs in D.P.U. 09-30. Similarly, the inclusion of small diameter cast iron and wrought iron mains in D.P.U. 12-

[11] These levels were significantly lower than what would have been expected when the Department approved TIRF to support an *accelerated* replacement program. Thus, the 2013 levels are more in line with expectations at the time.

25 was a proposal proffered by the Company, yet neither it nor the DOER ever in noted the inclusion of carrying costs as a requirement of the proposal. Thus, because the changes that DOER cites as reasons to support the DISC are not changes circumstances from what was known when D.P.U. 09-30 was decided, the Department should reject DOER's assertion that the Company's DISC proposal is reasonable.

3. THE DEPARTMENT SHOULD REJECT BAY STATE'S PROPOSED WAIVER PROCESS OF THE DEPARTMENT'S 38-MILE TIRF THRESHOLD

In its Brief, the AGO recommended that the Department reject Bay State's proposed waiver process for the Department's 38-mile TIRF threshold, and the DOER agreed, noting:

> the Company does not need the Department's prior approval to request a waiver of the 38-mile requirement. Should there be circumstances that prevent the Company from meeting the 38-mile threshold, it is always free to petition the Department stating the circumstances that prevent the Company from meeting these obligations and its proposed remedy.

DOER Br., p. 3. The Company, in its Brief agreed, stating that it "does not dispute this premise." Co. Br., pp. 47-48. The Department should take note that here the parties are in agreement that the Company's request is completely unnecessary, with the Company's request "only to establish some guidelines to apply to [a waiver] process." Co. Br., p. 48. The AGO recommends the Department reject the notion that it needs to develop a new process for handling waivers of the 38-mile threshold replacement level.

Specifically, the record in D.P.U. 12-25 is clear that the Department was compelled to adopt the 38-mile threshold level of replacement activity given the Company's "poor" pipeline replacement performance in the three years following its TIRF adoption. AG Br., p. 40, *citing Bay State Gas Company*, D.P.U. 12-25, pp. 47 and

54-55. The Department even noted that "the Company's pre-TIRF levels of main replacement exceeded the annual replacement levels that were experienced after the TIRF was approved." D.P.U. 12-25, p. 54. In developing the 38-mile threshold level, the Department consulted historical Bay State pipeline replacement activities, specifically the average annual replacement rate for the years 2007 through 2011. *Bay State Gas Company*, D.P.U. 12-25, p. 54. In this manner, the performance standard adopted by the Department was clearly set to be consistent with historic trends and designed in a fashion to incent the Company to replace mains at a rate consistent with at least minimum expectations, as well as the Company's assertions at the time of the TIRF's approval. D.P.U. 12-25, pp. 53-54 (2012).

Furthermore, the Company's belief that it may have difficulties in the future meeting the Department's 38-mile replacement threshold ignores Bay State's own time schedule for replacement activities. Mr. Bryant, president of Bay State, stated testified on cross-examination that it was "looking at orders of magnitude somewhere in the fifteen to twenty-year range" for replacement of all of the Company's leak-prone infrastructure. Tr. Vol. I, p. 105; *see also* Exh. CMA/SHB-1, p.5. With the utility having 1,082 miles of such infrastructure on its system at the end of 2012,[12] Bay State must average approximately 54 to 72 miles of replacement per year to meet its internal deadline of replacing all of its leak-prone infrastructure in 15 to 20 years. Tr. Vol. 1, pp. 105-106. This is a full 42 to 89 percent greater than the Department's threshold adopted in D.P.U. 12-25. AG Br., p. 41. The record is clear that the Department's minimum threshold of replacement was intended to be just that—a minimum threshold of

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[12] The Company possessed 1,103 miles of leak-prone pipeline at the end of 2011, and replaced 21 miles in 2012. *See*, D.P.U. 12-25, Exhibit CMA/DAR-1, p. 43. Exhibit AG/DED-1, Schedule DED-11.

replacement. Given the Company's anticipated rate of replacement, the Company should have little difficulty meeting this expectation through its accelerated pipeline replacement efforts funded by the TIRF.

Lastly, the Company states that the AGO argues that a Department approved waiver provision "would be deemed as the 'equivalent to a pre-determination of prudence.'" Co. Br., p. 48. This is a misrepresentation of AGO's position. The AGO merely warns that approving such requests "carries the additional uncertainty" that the Company may claim they are equivalent to a pre-determination of prudence. AG Br., p. 41. Ultimately, establishing a built-in waiver process seems contrary to the very spirit of the 38-mile threshold, as the threshold should be a minimum requirement that the Company is required to meet, as a condition of accelerated recovery, not a choice on a menu of options. The waiver should be used sparingly and need not be enshrined as a formal part of the TIRF. Accordingly, the AGO recommends the Department reject the Company's proposal to establish a waiver process as completely unnecessary and inimical to the purpose of the 38-mile threshold. Furthermore, if the Department should decide in the future to waive the 38-mile threshold, the Department should specifically indicate that its decision does not impact any future prudence determinations.

4. THE DEPARTMENT SHOULD REJECT UNSUBSTANTIATED BENCHMARKING ARGUMENTS PRESENTED BY THE COMPANY

The Company makes a series of arguments questioning the quality of Dr. Dismukes' cost benchmarking analysis. Co. Br., pp. 40-42. However, it should be noted that none of these positions, nor any of Dr. Dismukes' proposals for that matter, were raised by the Company in rebuttal testimony. Instead of presenting factual evidence supporting the Company's claim that it is a good cost performer, the Company makes unsubstantiated claims that the analysis presented is “completely flawed.” *Id*., p. 40. The Company’s attempt to discredit Dr. Dismukes’ benchmarking analysis is nothing but a smokescreen designed to obfuscate its own failure to provide direct evidence on this matter. The Company has had ample opportunity through the rebuttal process to present expert testimony on these matters and it simply failed to do so. The Department should find that Dr. Dismukes benchmarking analysis, conclusions and recommendations have not been refuted by the Company.

5. THE DEPARTMENT SHOULD IMPLEMENT A NEW PERFORMANCE METRIC THAT HOLDS A COMPANY’S TIRF-RELATED RETURN ON EQUITY ACCOUNTABLE TO ANNUAL LEAK REDUCTION PERFORMANCE

Bay State’s historically poor TIRF performance record, coupled with its current request to jettison Department rulings in D.P.U. 09-30 and D.P.U. 12-25, more than justifies rejecting the Company’s proposed modifications to the TIRF. However, the Department should move one step further and establish a new mechanism that scales Bay State’s TIRF-related return on equity directly to the Company’s achievement of leak-based performance standards. The AGO recommended in the last Bay State rate case that the Department adopt strict leak-rate based performance targets for Bay State to meet. *Bay State Gas Company*, D.P.U. 12-25, p. 34. The AGO renews its recommendations that the Department adopt strict leak-rate based performance targets for the Company. Since the TIRF’s inception, Bay State’s leak inventory has increased considerably compared to pre-TIRF levels, creating harmful economic, environmental, safety, and reliability conditions for ratepayers. Setting strict leak-rate based performance targets with corresponding adjustments to Bay State’s TIRF-related return on equity would tie the TIRF to achieving meaningful public benefits from reduced natural gas leaks, while eliminating existing concerns of program continuity.

The Company claims the AGO's recommendation that the Department implement a new leak-related performance metric contains several flaws. First, the Company argues that active leaks on the Bay State system have not increased as much as the AGO has asserted, claiming that the figure cited by the AGO refers only to the Company's inventory of Type 2 that it is required to monitor in accordance with state and federal pipeline safety regulations. Co. Br., p. 49. The Company further claims that the number of Type 2 leaks existing on the Company's system at any time "provides no indication of, and is not correlated with, the effectiveness of the Company's infrastructure replacement program in eliminating leaks." *Id*., p. 50.

Here, the Company attempts to confuse the issue surrounding its poor performance by making distinctions that are irrelevant to the question at issue. Bay State's TIRF mechanism was premised on reducing leaks on the Company's system through the replacement of leak-prone facilities. *Bay State Gas Company*, D.P.U. 09-30, p. 133. It goes without saying that one of the expected consequences of the implementation of the TIRF was a reduction in the number of active leaks on the Company's system. However, as shown by Dr. Dismukes, the Company's leak inventory has "increased dramatically" in the aftermath of the implementation of the TIRF and has "skyrocket[ed]" in the last two years. Exh. AG/DED-1, p. 35. An alternative performance metric, such as the one suggested by Dr. Dismukes upon cross-examination and adopted by two utilities in New Jersey, would tie Bay State's TIRF-related return on equity directly to the Company's ability to reduce its leak inventory. Tr. Vol. XII, pp.

1222-1224; and RR-DPU-25. The Company's semantic arguments aside, this alternative performance metric is another means to tie the Company's TIRF expenditures to the realization of meaningful public benefits from the reduction of natural gas leaks.

The Company's second argument pertains to the AGO's specific proposal to reduce annual corrosion-related leaks by five percent per year for the Company's mains and seven percent per year for services. AG Br., p. 48. The Company claims that it has "no control whatsoever" over leaks currently occurring. Co. Br., p. 50. Indeed, it even attempts to twist statements made by Dr. Dismukes to incorrectly support this statement, claiming he "acknowledge[d] the fact that there are factors beyond a company's control that affect the leak rate on leak-prone main, such as fluctuating weather conditions." *Id*. In reality, the record shows that Dr. Dismukes made no such statement, and the referenced material relates to comments on how physical factors and utility procedures can influence leak rates on the systems of different utilities. Tr. Vol. XII, pp. 1220-1221. More broadly, using the Company's reasoning that the accelerated replacement of leak-prone infrastructure is not positively reducing system leaks, the Department should seriously question the need for the program in its entirety. As stated by Dr. Dismukes, "[I]f replacing the leak-prone pipe isn't going to replace the leaks, [t]hen we might want to ask the policy question why we're doing it." Tr. Vol. XII, p.1221.

Finally, the Company claims that "No circumstances have changed . . . since D.P.U. 12-25," where the Department previously rejected a proposal by the Attorney General to implement a leak-based performance standard. Co. Br., p. 51. The AGO respectfully disagrees. As shown by Dr. Dismukes, the Company's leak inventory has "increased dramatically" in the aftermath of the implementation of the TIRF, and in particular has "skyrocket[ed]" in the last two years. Exh. AG/DED-1, p. 35. Likewise, the cost effectiveness of Bay State's replacement efforts have significantly worsened through the course of the TIRF, with replacement costs per mile of replaced main more than tripling since 2008 or increasing by an entire factor of eight since 2007. Exh. AG/DED-1, Schedules DED-10 and DED-11. Bay State's continual poor TIRF performance record provides more than enough justification for the Department to implement a new performance metric. Furthermore, if the Department continues to be concerned that such a mechanism would be unworkable due to the belief that "distribution system leak-rate fluctuates year to year independent of factors within the Company's control," (D.P.U. 12-25, at 52) the alternative proposal of linking the Company's TIRF-related rates of return with reductions in active system leaks suggested by Dr. Dismukes can be adjusted to exclude newly occurring leaks, as is done in the New Jersey examples Dr. Dismukes cited. Tr. Vol. XII, pp. 1222-1224; and RR-DPU-25.

6. THE DEPARTMENT SHOULD ACCEPT THE AGO'S PROPOSED UPDATE TO THE EXISTING O&M CREDIT AND PROPOSED SYSTEM MODERNIZATION CREDIT

The Company disagrees with the AGO's proposal to modify the existing O&M offset of $2,542 per-mile of non-cathodically protected steel main with a new value of $2,771 per mile averring that "[t]here is no reason for this change to the mechanism other than to roll another year in so as to increase the O&M offset, which is a premise already rejected by the Department." Co. Br., p. 52, citing D.P.U. 12-25, p. 60. The Company's position is completely inaccurate. It is true the Department rejected a prior proposal to utilize a four-year average of leak repair costs in D.P.U. 12-25 in favor of a three-year average. *Bay State Gas Company*, D.P.U. 12-25, p. 60 (2012). However, the AGO's proposal here is not just to change to a four-year average, but more importantly to update the O&M offset developed in D.P.U. 12-25. Dr. Dismukes has provided updated estimates of $2,949 per mile based on a three-year average and $2,771 per mile based on a four year average. AG Br., p. 49; and Exh. AG/DED-1, p. 73. Although the Department utilized a three year average of historic leak repair costs in establishing an appropriate O&M credit D.P.U. 12-25, the AGO recommends the Department adopt a new O&M credit of $2,771 per mile based on Dr. Dismukes' four year average. AG Br, p. 49. Importantly, this is the lesser of the two updated estimates, contrary to the Company's assertions. Also, it should be noted that no party to this proceeding has contested Dr. Dismukes' revised estimates. Therefore, the Department should adopt a new O&M credit of $2,771 per mile based on Dr. Dismukes' updated four-year cost average; however, if the Department decides not to change its three-year methodology adopted in D.P.U. 12-25, the Department should adopt a new O&M credit of $2,949 based on Dr. Dismukes' updated three-year cost average.

Lastly, the Company resists the AGO's proposal to implement a new System Modernization Credit to account for significant reductions in O&M costs associated with regulator stations due to the Company upgrading to higher pressure systems using smaller diameter mains. Co. Br., p. 52. The Company argues that the cost of operating regulator stations differ from one station to another, and therefore the request is "entirely speculative and unnecessary." *Id*. According to the Company's filing, it plans to reduce the current total of 215 regulator stations on its system to 60, a full 72 percent reduction in the number of regulator stations. AG Br., p. 50, citing Exh. DEM-1, pp. 14-17 and Tables CMA/DEM 4, 5 and 6. Currently, Bay State allocates 100 percent of the savings associated with reduced regulator station O&M to shareholders, but 100 percent of the costs associated with pipe replacements to ratepayers—this is clearly inequitable. The Department should therefore develop a new credit which passes O&M savings along to customers based on the proportion of regulator stations reduced from test year amounts. AG Br., pp. 50-51.

F. Rate Base

1. THE COMPANY HAS FAILED TO JUSTIFY INCLUSION OF THE FULL AMORTIZATION OF THE NIFIT & WMS SYSTEMS' DEFERRED O&M COSTS IN THE COST OF SERVICE AT THIS TIME

The Company states that "Attorney General Witness Effron stated that the benefits of both NIFIT and WMS began being realized as of their in-service dates (Exh. AG-DJE-Rebuttal-1 at 3 and 5). Thus, the costs associated for both projects are appropriate for amortization as proposed by the Company." Co. Br., p. 115. The issue, however, is the extent to which that amortization should be included in the Company's cost of service in the present case. Neither of the systems was in operation for the full 2012 test year, and thus the full annual benefits of these systems were not realized in the test year in this case. The amortization of the deferred O&M costs should be based on an appropriate matching of the costs and benefits of those systems.

The Company erroneously claims that "the matching of the costs and benefits associated with NIFIT and WMS that the Attorney General is advocating has already occurred." Co. Br., p. 122. This claim is based on the absurd notion that "[w]hen taken together, the June 30th and September 3rd Updates, the October 23, 2012 WMS in-service date and the late June 2013 NIFIT in-service date combine to achieve the matching of costs and benefits that the Attorney General is advocating." Co. Br., p. 123.

How these updates achieve a proper matching of costs and benefits is left unexplained. The WMS went into service in late October of 2012, and NIFIT was not implemented until June 2013. The updates did nothing whatsoever to change the fact that only two months of benefits of the WMS were reflected in the test year and none of the benefits of NIFIT were reflected in the test year. Perhaps if the updates had reflected some pro forma adjustment to annualize the WMS benefits and to recognize the cost saving benefits of NIFIT, the Company could argue that the updates achieved a proper matching of costs and benefits. However, the updates did nothing to change the Company's original filing in that regard and did nothing to achieve a proper matching of costs and benefits.

The Company is correct that "the primary benefits of WMS and NIFIT inured to the benefit of the Company's customers as of the in-service dates of the projects." Co. Br., p. 122. However, the in-service date of WMS was approximately two months before the end of the test year, and the in service date of NIFIT was approximately six months after the end of the test year. Therefore, to achieve a proper matching, the cost of service in this case should reflect two months' amortization of WMS deferred O&M costs and no amortization of NIFIT deferred O&M costs.

2. THE DEPARTMENT SHOULD REJECT THE COMPANY'S DEFENSE OF ITS TREATMENT OF THE EP&S SALE

Bay State claims that it has demonstrated that the $2,748,578 of retained Energy Products and Services ("EP&S") expenses appropriately remains in the utility cost of service. The Company states that the Attorney General concedes that the individuals reassigned from EP&S to O&M work on the Bay State distribution system are charging time to distribution activities in 2013. Co. Br., p. 126. There is no dispute that those individuals' time is actually being charged to Bay State in 2013. However, the issue is whether that labor expense is properly includable in the Company's distribution cost of service in the present case. Other than offering the conclusory statement that these employees are currently productively deployed on O&M activities for Bay State (Co. Br., pp.126-127), the Company provides little evidence that would establish that these employees were engaged in activities necessary to the provision of safe and reliable gas distribution service. Bay State certainly did not present any evidence that would justify the inclusion of salary and fringe benefits for the relevant employees of **$173,666 per full time equivalent employee** (RR-DPU-24) in the gas distribution cost of service. The Company did not even attempt to defend the inclusion of non-directly assigned labor costs such as fleet, stores, outside services, and allocated call center, dispatch, and supervision costs, which total $1,359,248 (total expenses of $2,748,578, less $1,389,330 of direct labor and benefits per RR-DPU-24), in the Bay State cost of service.

Bay State also opposes the recognition of carrying charges on unamortized gain on the sale of EP&S. Tellingly, the Company does not even dispute the financial and economic principles requiring the recognition of carrying charges on the unamortized gain on the sale of EP&S. Rather, Bay State offers a grossly distorted rendition of the supposed Department precedent on this matter. In response to the AGO's position that carrying charges were recognized on the unamortized proceeds of asset sales in association with electric utility restructuring, the Company begins by asserting that "the Attorney General's description and representations regarding how the RVC was constructed and operates pursuant to these restructuring cases is inaccurate." Co. Br., p.

127. In support of this assertion, the Company erroneously claims that "there is no calculation of carrying charges on the mitigation dollars contained in the RVC." Co. Br., p. 128. This erroneous claim is based on selective citations to Department orders where the residual value credit was discussed without any explicit mention of carrying charges and inferring from that there were no carrying charges.

For example, the Company cites the description of the RVC in *Western Massachusetts Electric Company,* D.T.E. 97-120. Because the cited passage does not refer to carrying charges, the Company concludes that that there were no carrying charges on the proceeds from the sale of Western Massachusetts Electric Company's generating units. Co. Br., pp. 128-129. However, the absence of reference to carrying charges in the cited passage does not mean that there were no carrying charges. Indeed, reference to Western Massachusetts Electric Company Exhibit MJM-3, Pages 4 and 4A in D.T.E. 06-35 clearly and unambiguously show that carrying charges were, in fact, accrued on the proceeds from the divestiture of that company's generating units at the pre-tax average weighted cost of capital.[13] (Those particular pages show how the divestiture mitigated the transition charges. Obviously, to count as mitigation, the return on the proceeds from the divestiture had to be credited to customers.)

The Company then argues that "[t]he Department was even more explicit on the operation of the RVC with no inclusion of carrying charges in *Massachusetts Electric Company and Nantucket Electric Company*, D.P.U./D.T.E. 97-94." Co. Br., p. 129. The two sentences cited by the Company simply state that:

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[13] Pursuant to 220 C.M.R § 1.10(3), the AGO incorporates by reference Western Massachusetts Electric Company Exhibit MJM-3, Pages 4 and 4A in D.T.E. 06-35 for the purpose of rebutting Bay State's false assertions.

> [t]he residual value credit reduces the fixed component by the amount of the proceeds paid to NEP by USGenNE, net of certain cost incurred by NEP as a result of divestiture. The effect of crediting the residual value credit to the fixed component is that the resulting CTC collects only those unrecovered sunk generating plant and regulatory asset costs not recovered through the proceeds of divestiture.

D.P.U./D.T.E. 97-94, p. 11. This passage neither states nor supports a reasonable inference that RVC did not include carrying charges.

The Company is correct that in the brief passage that it cites from *Fitchburg Gas and Electric Company*, D.T.E. 97-115/98-120, there was no discussion of carrying charges relating to the RVC. Again, the absence of such discussion cannot reasonably be interpreted to mean that there were no carrying charges. The question of whether the RVC implemented by Fitchburg Gas and Electric Company actually includes carrying charges can best be answered by reference to that company's CTC reconciliation filings. For example, in D.P.U. 12-121, Schedule DC-1, Page 8 shows the calculation of FGE's RVC.[14] As can plainly be seen on that schedule, the RVC includes a return at the before tax average weighted cost of capital. The Company is simply mistaken, as a matter of incontrovertible fact, when it says that the RVC does not include carrying charges.

As support for its claim that Department precedent does not provide for carrying charges on the gain of utility property that has been sold, the Company cites to *Fitchburg Gas and Electric Light Company*, D.P.U. 07-71 (2008). Co. Br., p. 130. In the passage cited by the Company, the Department stated that: "[c]oncerning the Attorney General's proposal to apply interest at the pre-tax weighted cost of capital, we have not previously required companies to pay interest to customers on the proceeds of sales of properties at

[14] Pursuant to 220 C.M.R § 1.10(3), the AGO incorporates by reference Schedule DC-1, Page 8 form the Company's filing in D.P.U. 12-121 for the purpose of rebutting Bay State's false assertions

the pre-tax weighted cost of capital or any other measure of carrying costs." D.P.U. 07-71, p. 66.

Aside from the fact that the Department was addressing the sale of a discrete unit of real estate (2.37 acres of land at Smith Street), and not the sale of a business unit, in that passage, the Company conveniently omitted the remainder of the Department's analysis on which its findings were based:

> The Attorney General's proposal was first raised in her reply brief, and the record is insufficient to establish the propriety of such an adjustment. Therefore, the Department declines to order that interest be added to the passback on the gain on the sale of the Smith Street property.

Id., p. 66.

Ultimately, the Department's finding to deny carrying charges in D.P.U. 07-71 was not based on precedent or on any ratemaking principle, but rather on its conclusion that the record in that case was "insufficient to establish the propriety of such an adjustment." In fact, the Department implicitly recognized that with a more complete record, it was entirely possible that the application of interest at the pre-tax weighted cost of capital could be appropriate. The record in the present case is sufficient, and other than its selective, distorted, and obviously erroneous version of Department "precedent" on this issue, the Company has offered no reason to deny the recognition of carrying charges on the unamortized gain on the sale of EP&S.

3. DESPITE BAY STATE'S ASSERTION, D.P.U. 10-55 DOES NOT SUPPORT BAY STATE'S USE OF 2011 DATA IN DETERMINING ITS COLLECTION LAG

In preparing its lead-lag study, the Company used 2012 test year data for all components, except the collection lag, which used 2011 data. Tr. Vol. V, p. 476. Bay

State's cash working capital request should be revised to reflect the use of the 2012 test year data for all components of the lead-lag study, including the collection lag, for the reasons delineated in AGO's Initial Brief. AG Br., pp. 66-68. This results in a minimum reduction to cash working capital of $2,338,123.

In addressing AGO's recommendation that the collection lag should, consistent with the other components of the lead-lag study, be based on 2012 data, Bay State relies, in part, on Department's Order in *Boston Gas Company, Essex Gas Company and Colonial Gas Company each d/b/a National Grid*, D.P.U. 10-55. Bay State argues that "The Department has determined that when the 'test year collection lag' is 'an anomaly, and not representative' the Department will allow the use of past collection lag data which 'more closely resembles . . . past collections lags."' Co. Br., 68 *citing National Grid*, D.P.U. 10-55, p. 204 (2010). Bay State indicates that "the Department should follow this precedent in this case and adopt the Company's collection lag proposal." *Id*.

On the contrary, the partial quote that the Company adduces is misleading and not truly reflective of the Department's position in that case.

Specifically, the Department's order in D.P.U. 10-55 states:

> The Department finds that Boston Gas experienced an unusually high collection lag in the test year. A collection lag of this magnitude, however, was not evident in 2007 or 2008 (see RR-DPU-55, Atts. A, B), nor has it persisted above the test year. As such, the test year collection lag for Boston Gas is an anomaly and not representative of both past and present time delay between the issuance of customers' bills and the receipt of billed revenues. The Department, therefore, finds that it is reasonable and appropriate to adjust the test year collection lag to reflect a more representative delay period. The collection lag ultimately will affect the total CWC approved for Boston Gas and, as such, it is essential that Boston Gas collect an amount of CWC that meets, not exceeds, its actual needs.

> The average of Boston Gas' 2007 and 2008 collection lags amounts to 43.06 days (RR-DU-55, Atts. A, B). This collection lag amount more closely resembles Boston Gas' past collections lags, and is consistent with the collection lags that have been reported to the Department in National Grid's recent filings…

D.P.U. 10-55, p. 204.

In D.P.U. 10-55, the Department considered the collection lag for the 2 years prior to the test year (2007 and 2008) and the collection lag that was reported by Boston Gas subsequent to the test year in determining that the test year collection lag was not representative. In the current case, Bay State has merely replaced the 2012 collection lag with the 2011 collection lag. It did not provide the 2010 collection lag or the actual collection lag it has experienced subsequent to the 2012 test year for comparison to the 2012 test year collection lag for the Department's consideration. Rather, it merely compared test year data to the prior year. Therefore, the Department should reject Bay State's attempt to artificially increase its cash working capital request by mixing 2011 and 2012 data.

G. Operations and Maintenance Expenses

1. SERVICE COMPANY CHARGES FROM NISOURCE CORPORATE SERVICE COMPANY

a) Bay State's Attempts to Downplay the Significant Increases in Charges from NCSC Should be Disregarded

In its Initial Brief, Bay State attempts to downplay the AGO's concerns regarding the significant and continual increases in the charges to Bay State from NCSC. In explaining the significant increase in costs charged to Bay State from NCSC, the Company states, in part, that "a portion of the cost increases are not actual increases because functions have been transferred into the service company from operating affiliates so that increases in NCSC costs are offset by decreases in local operating costs." Co. Br., p. 100. Bay State also argues that "These changes are a function of the way the NGD group has elected to provide shared resources in order to assure safe, reliable, and cost-effective service via the NCSC service agreement and billing system." *Id*.

If, in fact, the cost increases have been offset by "decreases in local operating costs," then other affiliated entities in other states have apparently been reaping the purported rewards and not Bay State or its customers in the Commonwealth of Massachusetts. One need only look at the employee counts to see the fallacious nature of the Company's contention that a portion of the cost increase is due to a shifting of employees out of the local operating companies into NCSC. If that were true, as Bay State contends, one would expect a similar decline in the employee count and associated labor costs at the operating company level.

However, the figures do not support Bay State's contention. During the 2012 test year, the total charges to Bay State from NCSC increased 8.14%, direct charges to Bay State increased 8.26% and indirect charges to Bay State increased 7.95%. Exh. AG-DR-1, pp. 7-8. During that same time period, the labor costs charged to Bay State from NCSC increased from $14,056,422 in 2011 to $16,065,843 in 2012, which is a $2 million or 14.3% increase in a single year. Exh. AG-14-4. During that same period, the staffing at Bay State did not decline as the Company would lead the Department to believe; rather, the number of employees at Bay State increased. As of December 31, 2011, Bay State had 559 employees. At the end of the 2012 test year, the employee count increased by 12 employees to 571. Exh. AG-1-44, Attachment AG-1-44, pp. 1-2. While employment did fluctuate at Bay State during 2012, the average employee count in 2012 exceeds the average 2011 employee count. Clearly, the significant $2 million (14.3%) increase in the labor costs charged to Bay State from NCSC during 2012 was not offset by decreases in labor costs at Bay State as the employment at Bay State increased during the same twelve month period.

In a further attempt to trivialize the significant increase in costs charged to Bay State from NCSC, Bay State indicates that "the annual cost amounts cited by the Attorney General are gross amounts, not excluding capitalized amounts associated with work projects specifically undertaken for the Bay State system . . . ." Co. Br., p. 100. This contention is misleading. The AGO has brought this annual gross increase in the amount of service company charges to the Department's attention to demonstrate that Bay State's operating and maintenance expenses (excluding capital) increased from $36,346,276 in 2011 to $38,730,911 in 2012 (Exhibit AG-DR-1, p. 9), which is an increase of $2,384,635 ($38,730,911 - $36,346,276) or 6.6% in a single year.

In an even further attempt to explain the significant increases in charges to Bay State from the service company, the Company indicates that the annual cost amount for 2012 includes $681,837 relating to the upgrade of the Work Management System, "which is a project completed at the service company level, but performed solely for the benefit of CMA." Co. Br., p. 100. Bay State has not removed the $681,837 charged from the service company during the test year for work on the WMS; instead, it has shifted the costs to its WMS adjustment for recovery from ratepayers. Even if one were to remove the $681,837 of WMS costs from the amount charged to Bay State from NCSC during the test year for comparison purposes, the increase in O&M expenses charged from

NCSC to Bay State is still $1,702,798 ($38,730,911 - $681,837 - $36,346,276) or 4.7% in a single year, which far exceeds inflation.

In explaining the various changes in costs charged by NCSC to Bay State, the Company indicates that "[t]here are very specific reasons for the cost changes and, once made, the changes do not continue to occur." Co. Br., p. 101. Oddly, this statement suggests that the numerous changes in costs charged to Bay State from NCSC are somehow one-time costs that do not continue or recur. If the cost changes do not "continue to occur," then one would expect the costs to either stabilize or decline in subsequent years—this clearly has not occurred. In fact, the opposite is true. The total costs charged to Bay State from NCSC increased by 24.56% between 2008 and 2009, 4.96% between 2009 and 2010, 4.59% between 2010 and 2011 and 8.14% between 2011 and 2012. Exh. AG-DR-1, p. 7. This upward trend indicates that the costs changes have, contrary to the Company's argument, "continue[d] to occur." The facts show significant increases in charges from NCSC to Bay State each and every year for the past four years. And while Bay State did shift the WMS costs from the NCSC costs to its WMS adjustment in this case, the charges from NCSC still increased significantly and well above inflation levels in 2012 and each of the prior three years.

b) Costs Allocated from NCSC During the Test Year for Services Provided by Messrs. Skirtich and Mouser are for Assistance in the Prior Rate Case

In responding to the AGO's removal of the test year charges from NCSC for the services of Messrs. Skirtich and Mouser, the Company contends that "Mr. Gore explained at length that both Messrs. Mouser and Skirtich are not rate case consultants" and that the supporting work they performed in the test year related to the last rate case "is typical of the kinds of service both individuals can provide, as needed." Co. Br., p. 106. The Company's Brief goes on to state that "[a]lthough the specific assignments related to the last rate case may not recur, the activities performed in the test year are fairly typical of the kinds of assignment both individuals routinely perform for all NGD companies." *Id*.

Just because these individuals have a long-standing relationship with NCSC and are contract employees does not mean that the costs charged to Bay State during the test year for their work on the prior rate case, D.P.U. 12-25, should not be removed. In future years, if the time for these two contract employees is spent assisting in rate cases for other NiSource Gas Distribution ("NGD") companies, then their costs would be allocated to those other NGD companies. The record evidence shows that the charges from NCSC to Bay State for the services of Mr. Skirtich and Mr. Mouser during the test year were predominately for assistance in the prior rate case and should thus be removed from the test year. *See* AG Br., pp. 86 – 89; Exh. AG-24-12; Exh. AG-28-3.

c) Bay State Mischaracterizes the AGO's Statements with Regards to the Allowance of an Inflation Adjustment

In its Brief, the Company states "In both her initial testimony and at the evidentiary hearing, Ms. Ramas states that the Department **will** allow an inflation adjustment if a company has demonstrated that it has implemented cost containment measures." Co. Br., p. 13 (emphasis added). The Company cites Exhibit AG-DR-1, p. 24 and Tr. I, p. 1109 as support for this statement. This is a mischaracterization of her testimony. In neither of those citations did Ms. Ramas state that the Department "will" allow an inflation adjustment if the company demonstrates that cost containment measures have been implemented, nor does she make such a recommendation. Rather, Ms. Ramas indicates that prior to allowing an inflation adjustment a utility must demonstrate it has implemented cost savings measures. It is important to note, however, that the allowance of an inflation adjustment is not mandatory once this minimum threshold has been met.

Ms. Ramas indicates that the Department allowed for the application of an inflation adjustment in the last case, D.P.U. 12-25, finding that "In order for the Department to allow a utility to recover an inflation adjustment, the utility must demonstrate that it has implemented cost-containment measures." D.P.U. 12-25, p. 245 *citing* D.P.U. 09-30, at 285; D.P.U. 08-35 at 154; D.T.E. 02-24/25, at 184. Exh. AG-DR-1, p. 24. While it is correct that Ms. Ramas pointed out that the Department did allow the application of an inflation adjustment on non-labor charges to Bay State from NCSC in the prior rate case, she did not indicate that the Department "will allow an inflation adjustment if a company has implemented cost containment measures." Instead, she indicated that in order for the Department to allow an inflation adjustment, the utility must demonstrate cost-savings measures. Exh. AG-DR-1, p. 24. Similarly, while being cross-examined by Company counsel regarding the Department's order in DPU 12-25, Mr. Ramas state, "It indicates that in order for the Department to allow a utility to recover an inflation adjustment, the utility must demonstrate that it has implemented cost-containment measures." Tr. Vol. XI, p. 1109. Neither of these sources cited by Bay State indicates that the inflation adjustment is mandatory or will be made if cost containment measures can be identified. The crucial distinction that the Company's Initial Brief neglects to make is that these sources indicate that the inflation adjustment is not even considered if a utility does not demonstrate that it has implemented cost-containment measures. The Department's hands are not tied with regards to whether or not it will allow an inflation adjustment because the allowance of an inflation adjustment is not mandatory. Bay State has provided no citations which indicate that the Department must grant an inflation adjustment in this case. Given the significant increase in costs charged to Bay State from NCSC, including the significant increase during the 2012 test year, coupled with the level of errors in the NCSC normalization adjustments presented by Bay State, the AGO recommends that the application of an inflation adjustment to the NCSC charges to Bay State be rejected.

d) Bay State Failed to Demonstrate That it Has Pursued Cost Savings Measures During the Test Year Beyond What Should Be Done in the Normal Course of Business

Even if NCSC had undertaken some remedial attempts to contain the service company costs that are allocated from NCSC to Bay State, clearly those efforts have fallen far short given the significant increases in costs charged to Bay State from NCSC in each of the last four years. As previously indicated *supra*, during the 2012 test year, total charges to Bay State from NCSC increased 8.14%, direct charges to Bay State increased 8.26% and indirect charges to Bay State increased 7.95%. Exh. AG-DR-1, pp. 7-8. What is more, these increases occurred during a period when the employee complement at Bay State also increased. Similarly, the total costs charged to Bay State from NCSC increased by 24.56% between 2008 and 2009, 4.96% between 2009 and 2010, 4.59% between 2010 and 2011, and 8.14% between 2011 and 2012. Exh. AG-DR-1, p. 7. Such significant, sustained increases are hardly indicative of a company implementing reasonable cost containment measures.

In response to the AGO's position that the Company has not undertaken a reasonable level of cost containment efforts to bring the charges from NCSC to Bay State under control, the Company refers to the rebuttal testimony of Suzanne M. Taylor as providing further support for cost containment measures implemented as NCSC. Co. Br., p. 135. The Company also asserts that, at the request of the Department, Ms. Taylor quantified some of those cost savings. *Id*. As pointed out in the AGO's Initial Brief, p. 80, the actions identified in Ms. Taylor's Rebuttal Testimony (Exh. CMA/SMT-1, pp. 9-11) are normal actions that any company should be taking in the normal course of operations and not reflective of a Company aggressively attempting to control cost increases. AG Br., p. 80. Additionally, the Company has provided no support for its purported quantification of the savings discussed in Ms. Taylor's rebuttal testimony. AG Br., p. 80. Therefore, the AGO continues to recommend that the Department reject Bay State's $848,129 adjustment to inflate the normalized test year charges from NCSC.

2. THE COMPANY HAS NOT DOCUMENTED THE 2014 NON-UNION WAGE INCREASE

The Company states that it "recognizes that the Department's valid concern regarding the inclusion of the costs associated with the planned 2014 merit increase in the approved cost of service without adequate confirmation that the cost will be incurred subsequent to the setting of rates." Co. Br., p. 76. It proposes to address that concern by filing a letter from management by mid-February 2014 committing to the 2014 merit increase once the final determination by management is made, claiming that this letter will conform to the Department's requirements for cost recovery of post test year non-union wage rate increases. Co. Br., pp. 76-77.

The mechanism suggested by the Company does not resolve the concern regarding the inclusion of the costs associated with the planned 2014 merit increase in the cost of service. In effect, the Company is asking the Department to pre-approve the letter it will file in January 2014, well after the record in the case was closed, as conforming to the Department's requirements for cost recovery. The Company has not documented the 2014 non-union wage increase, and the Department should not include that wage increase in the cost of service.

3. NCSC's Luxury Corporate Jets

Bay State Gas insists again on including the costs of NCSC's luxury corporate jets in its cost of service. Co. Br., pp. 107-108. While the Company changed the numbers associated with its test year costs during the proceeding, confusing itself and the Department, the fact still remains that these are excessive luxuries that should be borne by the Company's shareholders.[15] Indeed, telling is the Company's new argument that "leasing aircraft is an effective and efficient way to transport employees of a large enterprise in many states. *Id*. Also, there are in some instances where no airport hubs are located within the service territories of NiSource's companies." *Id*. Of course, there is no need land on a grassy field here, since Boston Logan is one of the places that is an "airport hub" that nicely services the Company's service territory. Essentially, the Company admits that it is allocating the costs of operating these luxury jets for the benefit of its other NiSource operating companies. Furthermore, the Company's claims

[15] It should be noted that while the Company chastises the Attorney General for using incorrect numbers from Exhibit AG-1-54, in her brief, regarding the claimed test year dollar amounts spent on these luxury planes, what in fact happened, was the Company attempted to change the claimed test year expense amounts in AG-1-54 in its later response to Information Request DPU-12-5, yet failed to update the original response in AG-1-54 to which DPU-12-5 referred. There are in fact two different numbers in the record for the luxury plane costs as a result of the Company's confusion.

that the increase in test year lease expense should be offset by the decrease in test year charter expense are also misplaced. Along with the acquisitions of the new leases will be all of the other potential costs including operations and maintenance expense, insurance, and taxes that would does not have to incur when planes are chartered or for that matter used as a regular ticketed passenger on commercial airlines. The Company has not demonstrated the need for one, much less a second luxury jet and therefore, the Department should deny the test year costs of both jets.

4. RATE CASE EXPENSE

a) Labor and Benefits Analyses

In its brief, the Company states that, "[t]he Attorney General claims that the costs associated with Aon Hewitt should be excluded from the Company's overall level of rate case expenses on the basis that the use of Aon Hewitt was inappropriate since the Company did not issue an RFP for a consultant to provide these services." Co. Br., p. 91. Rather than respond to the AGO's arguments *in the present case*, the Company instead chooses to address arguments made *in its last rate case*. *See* D.P.U. 12-25, p. 172 (AGO argued that Aon Hewitt rate case expense should be disallowed because the Company did not utilize the RFP process).

However, the AGO, as stated in its initial brief, recommends disallowance of the two invoices totaling approximately $15,000 because, contrary to the requirements of Department precedent, "[the invoices'] generic descriptions fail to provide the necessary detail for the Department to determine if the expenses were reasonable, appropriate, and prudently incurred and were proportional to the work performed."

The Company's mischaracterization of the AGO's position should not sway the Department from considering the lack of evidence presented in this case, nor should the Department allow the Company in its reply brief to argue as it should have here. *See New England Telephone and Telegraph Company d/b/a Bell Atlantic-Massachusetts*, D.T.E. 98-15 (Phase I), pp. 10-11 (1998) ("The Department disfavor[s] any party's attempt to have the last word by saving for a reply brief arguments that could have been raised in an initial filing."); *see also Henderson v. Commissioners of Barnstable County*, 49 Mass. App. Ct. 455, 459 (2012) (issues raised for the first time in a reply brief are not properly before the court). The Company has waived its right to comment on the sufficiency of the evidence presented in support of the Aon Hewitt rate case expense. *See Boston Gas Company*, D.P.U. 18960, p. 2 (1978) (company's failure to comment on customer's documentation, despite the opportunity to do so, constituted waiver of its right to object to the introduction of that documentation). Therefore, the Department should exclude the Aon Hewitt costs.

b) Legal Services

The Company argues in its initial brief that Keegan Werlin would likely be the lowest cost provider. Co. Br., p. 92. However, the bid numbers support a different conclusion. *See* DPU 1-3(a) Att. (Confidential), p. 1. Another in-depth analysis of the submitted bids is beyond the scope of this reply brief, so instead, the AGO lets the numbers speak for themselves. *See Id.*

The Company states that, "the dispositive issue for the Company was which law firm would be likely to minimize the overall number of hours of work required on the case. . . ." Co. Br., p. 92. It then concluded that Keegan Werlin was the firm most likely to require the lowest number of hours in litigating this case. *Id*., pp. 92-93. However, this suggestion strains the bounds of logic, because it runs contrary to the evidence presented in this case. The Company recommended hiring Keegan Werlin because:

> Keegan Werlin has the best overall experience among the bidders, including both experience in representing gas utilities in recent rate proceedings before the DPU and familiarity with CMA and NiSource; because its proposed rates are clearly *reasonable* when compared to competitive market rates for similar services in the area; and because it has offered viable cost-containment proposals, including discounted hourly rates and limits on the cost of preparing the application and handling the compliance phase of the proceeding…

DPU-1-3(b) Att. (Redacted), p. 13 (emphasis added). Conspicuously absent from this recommendation is any mention of Keegan Werlin being likely to work the least amount of hours. Perhaps it is missing because that assertion is patently untrue. While the Company claims that Keegan Werlin would "likely be the least-cost provider," DPU-1-4, this belief is unfounded. *See* DPU-1-3(a) Att. (Confidential), p. 1. Moreover, it is more likely that Keegan Werlin would be the highest cost provider. *See generally* AG Br. (Confidential), pp. 97-99. The logical inconsistencies presented in the Company's initial brief, and its case in chief, demonstrate that its selection of Keegan Werlin was unreasonable and not cost-effective. If the Company wants to pay a premium for Keegan Werlin's services, that premium should be borne by shareholders, not ratepayers. Furthermore, the Department could adopt an approach of rate case expense sharing. *See e.g.*, *Parkway Water Company*, B.P.U. WR05070634 (2006) (New Jersey Board of Public Utilities ruling that rate case expense would be a 50/50 split between ratepayers and shareholders, since both benefit from a rate case); *Pennsgrove Water Supply Company*, B.P.U. WR98030147 (1999) (same).

Additionally, the Company takes issue with the AGO's analysis of the legal service bids submitted to the Company. *See* Co. Br., pp. 93-95. In defense of its position, the Company maintains that the RFP bids are not indicative of the actual costs of litigating the rate case. *Id*., p. 93. In effect, the Company is asking to ignore the bids, which would run afoul of Department precedent as it relates to securing consultants. *See Boston Gas Company*, D.T.E. 03-40, p. 153 (2003) (in securing consultants, company must engage in a "structured, objective competitive bidding process for these services"). The Department should not allow the Company to dismiss the facts contained in the bids. To do otherwise reduces the RFP process to an illusory endeavor, conducted only for form's sake, and eliminates the Department's oversight role as it relates to rate case expense.

In its initial brief, the Company further argues that there is no basis to conclude that one of the firms not selected would have had a lesser total actual cost than Keegan Werlin. Co. Br. 94. In support, it states that "[t]he Attorney General has not performed any such analysis to show that the law firm not selected would have *actually* produced a lower cost because the Attorney General has no way to ascertain that the number of hours spent on the case would not have far exceeded both the initial estimate and the number of hours required by Keegan Werlin." *Id.* What the Company fails to acknowledge, is that the same is true of Keegan Werlin's bid. Additionally, despite the fact that the Company's position improperly shifts the burden from itself to the AGO, the AGO agrees that it could not have performed this type of analysis. Nor is this type of analysis necessary, because the Department has the RFP responses before it in this case. *See* DPU-1-2(b)(1)-(6) Att. (Confidential); 1-3(a) Att. (Confidential), p. 1. The information contained therein demonstrates that the selection of Keegan Werlin was facially unreasonable and not cost-effective. It remained the Company's burden to demonstrate that its selection was reasonable despite the documentation.

The Company further characterizes the AGO's initial brief as substituting its judgment for the Company in its selection of consultants. However, the Company's argument again misconstrues Department precedent. The AGO has not attempted to substitute its judgment for the Company's in selecting a consultant, but has instead asserted that the Company failed to demonstrate that its choice of Keegan Werlin was reasonable and cost-effective, as required by the Department. D.P.U. 11-01, p. 247. Nothing in the Company's initial brief has changed the fact that the Company failed to carry this burden.

H. Cost of Capital

1. THE AGGRESSIVE FINANCIAL PROFILE OF NISOURCE SHOULD NOT INCREASE RATES FOR BAY STATE CUSTOMERS

The aggressive financial profile of NiSource should not increase rates for Bay State customers. The Company's Brief highlights the unique riskiness of Bay State in supporting its cost of equity and overall cost of capital recommendation. Co. Br., pp. 156-157. However, a major omission of the Company's Brief is that the aggressive financial profile of Bay State's parent, NiSource, results in higher capital costs for Bay State. Exh. AG-JRW-1, pp. 14-16. In this case, the Department must recognize that Bay State's customers should not be required to pay higher rates because of NiSource's aggressive use of debt financing. NiSource's aggressive financial profile and risk is a major rating factor cited by Standard & Poor's in rating Bay State. *Id.*, p. 16.

NiSource's high debt leverage and financial risk increases the Company's claimed cost of capital in three ways. First, the Company has proposed a capital structure with a common equity ratio of 53.68 percent. Exh. CMA/VVR-1, pp. 53-55. As highlighted in the AGO's Initial Brief, this proposed common equity ratio is much higher than NiSource's average common equity ratio over the past three years of 43.26 percent, the median common equity ratio of 48.5 percent for Dr. Woolridge's Gas Proxy Group, and the average common equity ratio approved in gas rate cases in 2013 of 50.31 percent. AG Br., pp. 107-108. Second, the Company's debt cost rate is high because all debt capital comes in the form of intercompany notes where the ultimate borrower in the markets is NiSource Finance Corporation. *Id*. The S&P Issuer Credit Rating for NiSource Finance Corp. is BBB-. Exh. AH-1-11, p. 140. This rating reflects the parent company's aggressive financial profile and therefore results in higher debt capital costs for Bay State. Exh. AG-JWR-1, p. 5. Third, Bay State claims that it deserves a high equity cost rate since it is riskier than other gas companies. Co. Br., pp. 156-157. The Company uses its bond ratings in support of this claim for a higher equity cost rate due to its higher risk without acknowledging the aggressive financial profile of the parent company. *Id*.

It is the AGO's contention that the Department should draw the line in this proceeding and not allow the aggressive borrowing practices of Bay State's parent company, NiSource, to result in higher rates for Bay State's customers due to an overstated cost of capital. The Department can do this by (1) adopting the AG's proposed 50/50 capital structure which is more reflective of the actual and authorized capitalizations of gas companies (AG Br., pp. 107-108; (2) adjusting the Company's long-term debt cost rate to reflect as proposed by the AGO (AG Br., p. 108); and (3) ignoring Bay State's claim that it needs a higher equity cost rate to reflect its higher risk.

2. IT'S *DÉJÀ VUE* ALL OVER AGAIN

The Company's Initial Brief brings to mind one of Yogi Berra's best known quotes, "It's déjà vu all over again." Much of the Company's Brief focusses on supporting the return on equity recommendation of Bay State witness Mr. Rea. Co. Br., pp. 143-158. Mr. Rea has employed virtually all cost of equity approaches and adjustment mechanisms known to the world of finance in arriving at his 11.45% recommendation. Exh. CMA/VVR-1, pp. 7-11. In fact, Mr. Rea has argued that more equity cost rate approaches, applied to more companies, produces a better measure of the appropriate equity cost rate in this proceeding. *Id*., p. 59; Exh. CMA/VVR Rebuttal-1, pp. 26-27. But the Department has seen all of this before. In the Company's last rate case, Mr. Rea used the same methodologies and techniques in arriving at an equity cost rate recommendation of 11.75 percent.[16] D.P.U. 12-25, pp. 395-444 (2012). But, the Department evaluated the merits of Mr. Rea's 11.75 percent recommendation in the last case and awarded the Company a ROE of 9.45 percent. *Id*., p. 444. And the Department should reject his methods again in the current case because Mr. Rea's recommendation, despite the many approaches and proxy groups used, does not reflect the realities of the marketplace. As highlighted in the AGO's Initial Brief, Mr. Rea's recommendation is simply "Off the Chart" compared to the authorized ROEs for gas companies. AG Br., pp. 105-106.

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[16] The errors and omissions associated with Mr. Rea's equity cost rate approaches and inputs were detailed in the AG's main brief and will not be repeated here.

3. THE AGO'S 8.75 PERCENT RECOMMENDED ROE IS ADEQUATE FOR BAY STATE

In its Initial Brief, while recognizing that its recommendation is "Off the Chart" compared to the authorized ROEs for gas companies, the Company claims that the AG's 8.75 percent recommendation "would significantly undermine the Company's ability to sustain utility operations or to attract capital at a reasonable cost." Co. Br., pp. 179-180. To support this claim, the Company points to earned ROEs of gas companies as well as an average awarded ROE of 9.94% to gas companies in 2012. *Id*. Interestingly, the Company leaves out the results for 2013. As documented by Dr. Woolridge in his surrebuttal testimony, authorized ROEs have decreased in recent years and that decrease has continued in 2013. Dr. Woolridge shows that the average authorized ROE for gas companies of 9.94 percent in 2012 has declined to 9.5 percent in 2013. Exh. AG-JRW-Surrebuttal-1, p. 12. Therefore, authorized ROEs for gas companies have declined about 50 basis points since the Company's last rate case in 2012. *Id*.

I. Revenue Allocation and Rate Design

In its Initial Brief, the Company reiterates its initial filing regarding revenue allocation and rate design and ignores record evidence from hearings and record requests. Bay State continues to advocate use of the Department standard for revenue allocation between classes that no class should receive a rate increase in excess of 125 percent of the proposed rate increase. Co. Br., p. 193. The Company neglects to address the impact of St. 2012, c. 209, An Act Relative to Competitively Priced Electricity in the Commonwealth (the "Act"), which became effective in relative part for 2013, which imposes a 10 percent cap on rate increases for each customer class. The provisions of the Act will negate the need to provide subsidies to the C&I High Annual, Low Winter (G/T-

52) and C&I Extra High Annual, Low Winter (G/T-53) classes. AG Br., p. 133. Furthermore, the Company ignores the significant bill impacts for residential non-heating rates associated with D.P.U. 12-126. Because the Company did not brief its position on these revenue allocation impacts, the Department should adopt the revenue allocation recommendations summarized by the AGO in its Initial Brief. AG Br., pp. 131, 134.

The Company also reiterates its initial position regarding extra-large C&I class customer charges, despite support for the AGO's position from its rate design witness, Joseph A. Ferro in rebuttal and hearings. Customer charges for the C&I Low Winter Lg. Hi Annual (G/T-53) class should be established at $1209.36, which is the full cost basis as presented by the Attorney General's Witness Rebecca Bachelder. Exh. AG/RSB-1, p. 8.

III. CONCLUSION

The Department should reject the Company's proposed rate increase and should accept the AGO's recommendations as set forth in this reply brief.

Respectfully submitted,

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