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September 11, 2012

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. 12-25

Dear Secretary Marini:

Enclosed please find the **Public Version** of the Reply Brief of the Attorney General. The confidential version of the Attorney General's Reply Brief will be filed separately to just the Department and the Company.

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

Sincerely,

Assistant Attorney General

Enclosure
cc: Mark Tassone, Hearing Officer
Service List

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Bay State Gas Company d/b/a Columbia Gas of Massachusetts	)	**D.P.U. 12-25**

<u>CERTIFICATE OF SERVICE</u>

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 11th day of September, 2012.

Joseph W. Rogers
Assistant Attorney General
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cc: Service List

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Bay State Gas Company, d/b/a Columbia Gas of Massachusetts	))))	**D.P.U. 12-25**

<u>REPLY BRIEF OF THE ATTORNEY GENERAL</u>

Respectfully submitted,
MARTHA COAKLEY
ATTORNEY GENERAL

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REPLY BRIEF OF THE ATTORNEY GENERAL

I. INTRODUCTION

Pursuant to the briefing schedule established by the Department of Public Utilities (the "Department") in this proceeding, the Attorney General submits her Reply Brief responding to the arguments made by Bay State Gas Company, d/b/a Columbia Gas of Massachusetts ("Bay State" or "Company") in its Initial Brief.[1]

II. OVERVIEW

Bay State's Initial Brief is contains more hyperbole than citation to the record or Department precedent, and attempts to divert attention from the fact that it: (i) is replacing distribution infrastructure at a slower rate than before the Targeted Infrastructure Recovery Factor ("TIRF") was approved; (ii) charged customers for replacement costs in its depreciation rates that it will not actually incur; (iii) failed to refinance long-term debt that it has outstanding with its affiliate; (iv) failed to completely mitigate the increased costs that have resulted from the sale of its affiliate, Northern

[1] This brief is not intended to respond to every argument made or position taken by the Company. Rather, this Reply Brief is intended to respond only to the extent necessary to assist the Department in its deliberations. Silence by the Attorney General with respect to any issue addressed in the Company's Initial Brief cannot be construed as assent to its position.

Utilities; and (v) failed to mitigate the 36 percent increase in charges from its Service Company affiliate. Based on the record evidence and Department precedent, the Attorney General recommends that the Company's rates be reduced by $27,987,090.

III. ARGUMENT

A. RATEMAKING METHODOLGY

The Attorney General demonstrated that Bay State's claims that the Department has not provided "sufficient support" to the Company are without merit. Likewise, the Attorney General has shown that the Company has not proven the need for the proposed Rate Year/Rate Base ("RY/RB") mechanism or the proposed modifications to the annual review process for the Targeted Infrastructure Recovery Factor ("TIRF").

In its Initial Brief, Bay State claims that if the Attorney General's recommendations are adopted, the Company would be unable to engage in cost effective management or a robust infrastructure replacement program. Co. Br., p. 6. The Department should ignore the Company's transparent attempts to change the dialog from the Company's unsupported RY/RB and expanded TIRF proposals, and instead focus on the Company's failure to deliver on the purported benefits of the original TIRF mechanism since the mechanism's adoption in D.P.U. 09-30. *See e.g.*, Co. Br., pp. 4-5. The factual record, not the Company's unsupported arguments, should lead the Department to conclude that both the Company's proposed RY/RB mechanism and proposed modifications to the TIRF annual review process should be rejected.

1. THE PROPOSED RY/RB MECHANISM AND MODIFICATIONS TO THE TIRF ANNUAL REVIEW PROCESS ARE NOT CONSISTENT WITH DEPARTMENT POLICY ADOPTED IN D.P.U. 09-30.

The Company incorrectly claims that its proposed RY/RB mechanism and modifications to the TIRF annual review process are consistent with Department policy adopted in D.P.U. 09-30. Specifically, Bay State contends that contrary to the Attorney General's position, the proposed RY/RB mechanism is "targeted" in nature because it is limited (i) to only expenditures related to a subset of non-revenue producing infrastructure; (ii) in duration to only a 22-month period following the end of the test-year; and (iii) in recovery to only the lesser of the amount included in rates or actually expended. The Company therefore asserts that the RY/RB mechanism is appropriately targeted and provides more limited recovery than the existing TIRF. Co. Br., pp. 17-18. These are clear misrepresentations of the Department's policy precedent set in D.P.U. 09-30 and should be rejected by the Department.

First, the claim that the RY/RB mechanism is "targeted" in nature is misleading. The Company's proposed mechanism would allow for immediate cost recovery for almost 80 percent of Bay State's anticipated capital budget, moving its capital cost recovery through non-traditional ratemaking far from the "very specific category of non-revenue producing infrastructure" that the Department envisioned in approving the original TIRF mechanism. *Bay State Gas Company*, D.P.U. 09-30, pp. 133-134 (2009).

Second, that the RY/RB mechanism is limited to a 22-month period following the end of the test-year period is irrelevant. Nothing precludes Bay State from asking for the same mechanism or a similar mechanism in future years. Indeed, elements of the Company's filing indicate that this is exactly its intention if the Department approves the

RY/RB proposal in lieu of the modified TIRF. *See* Exh. CMA/SHB-1 p. 21. Such an argument casts the RY/RB as not only a phase-out of the TIRF mechanism, but also the establishment of a projected test year. Rather than establishing a new, expanded, mechanism to replace the TIRF for the 22 months following the end of the test-year period, the Department should immediately discontinue the TIRF mechanism.

2. THE PROPOSED RY/RB MECHANISM AND MODIFICATIONS TO THE TIRF ANNUAL REVIEW PROCESS CONSTITUTE A FORECASTED TEST YEAR.

Despite the Company's objection, the proposed RY/RB mechanism or modifications to the TIRF annual review process constitute a projected or partially forecasted test year. Relatedly, the Attorney General's reliance on the Department's language in D.P.U. 07-50-A is accurate. There, the Department addressed a specific proposal involving setting base revenue requirement based on a three-year forecast of: capital investment, O&M expenditures, A&G expenses, depreciation and taxes, as well as a three-year forecast of sales without any proposed mechanism for reconciliation if forecasted values differed from actual. Co. Br., p. 19.

The Company's claim would render meaningless the specifics of the Department's language in D.P.U. 07-50-A. Although the Department addressed a specific proposal in that proceeding, that does not mean the Company can ignore the Department's conclusions. In fact, the Department broadly considered future test years in that decision. *See* D.P.U. 07-50-A pp. 51-53. Bay State claims that the Department's holding only precludes proposals identical to the one rejected in D.P.U. 07-50-1; however, the plain language of the Order demonstrates that the Department did not intend for its holding to be read so narrowly. Furthermore, contrary to the Company's assertions, the Department's concerns with the speculation and uncertainty of forecasted test years was not limited solely to the presence of multiple forecasted variables. The Department was concerned with relying on *any* projected data in setting distribution rates:

> *We disagree with commenters who suggest that a future test year would not represent a radical change from our current ratemaking practice. It would.* The Department has previously considered and declined to adopt proposals to determine a distribution company's base revenue requirement on the basis of a forecasted test year. We have done so due to concerns about the time and resources needed to litigate all projected costs, revenue, and sales items, as well as the forecasting methods used to determine such projections. While National Grid argues that establishing distribution rates based on the future test year would most closely align a distribution company's revenues with costs, we have previously stated that the 'Department views the adoption of the future test year as fraught with speculation and uncertainty… [and there] are too many variables which affect the cost of service to justify employing a future test period.' *Our reluctance to rely on projections of future results is based on the 'well-ground apprehension that subjective factors will result in unreliable results.'* The Department has previously stated that a future test year 'could have detrimental effects on the rights of due process of parties to its proceedings.

D.P.U. 07-50-A, pp. 51-52 (emphasis added, internal citations omitted).

Bay State's RY/RB proposal and the Company's proposed modifications to the TIRF annual review will undoubtedly rely on projections of anticipated capital expenses in order to determine new distribution rates. These are exactly the sort of projections upon which the Department indicated its reluctance to rely upon in D.P.U. 07-50-A.

3. BAY STATE'S CLAIMS CONCERNING NISOURCE PRESENTATIONS TO RATING AGENCIES ARE MISLEADING.

The Company's asks the Department to ignore that it parent Company, NiSource, does not share the view that Bay State's [redacted]. Bay State argues that "NiSource addressed [redacted] The Company further contends that "[i]f NiSource did [redacted]. Co. Br., p. 32.

The Company's argument is faulty and misleading more for what it doesn't discuss than for what it does. Although NiSource did [redacted] NiSource did not view this as a cause of [redacted]. Instead, NiSource discussed several factors contributing to lower earnings such as: [redacted] Not once in all of its presentations to rating agencies did NiSource reference infrastructure replacement investments or challenging regulatory cost recovery mechanisms as contributing to earnings erosion. If NiSource truly believed that such challenges were contributing to Company earnings erosion, one would expect NiSource to have included it as a contributing factor in its presentations. Exh. AG/DED-1, at 62-64. The Company's argument is also refuted by the fact that the Company has been replacing distribution infrastructure at a slower rate than before the TIRF's approval. Exh. AG/DED-1, p.42; Tr. Vol. X, pp. 1305-1306. If under-recovery from replacement investments were a contributing factor to Bay State's alleged financial woes, this issue should have been alleviated by the Department's approval and the Company's implementation of the TIRF, not aggravated by it.

Even more glaring is the Company's failure to discuss the relative regulatory risks between various NiSource natural gas distribution utilities contained within the same financial presentations and the generosity of the TIRF mechanism in Massachusetts compared to the other states in which NiSource operates. In addition, the Department already provides a full suite of cost recovery mechanisms, and the Company's own representations to the investment community paint a relatively clear picture that [redacted]

4. BAY STATE'S ARGUMENT CONCERNING THE ATTORNEY GENERAL'S EARNINGS ATTRITION ANALYSIS AND COST COMPARISONS IS WRONG.

The Company first claims that Dr. Dismukes' analysis is flawed because he did not assess whether any of the companies in his peer group operated within a service company structure. Co. Br., p. 29. Second, Bay State asserts that Dr. Dismukes' analysis contained "mistakes," which Dr. Dismukes claims to have been the result of the inability to receive appropriate data from the Company. *Id.* fn. 16. Bay State's two claims regarding Dr. Dismukes' operating cost efficiency analysis are incorrect.

Bay State claims that all comparisons between the Company and similarly-situated peer companies performed by Dr. Dismukes are "rendered useless" by the fact that Dr. Dismukes did not assess whether any of the companies in his peer group operate within a service company structure. Co. Br., p. 29. This argument is illogical for the simple reason that operating within a service company structure, should, *ipso facto*, lower—not raise—costs. Co. Br., p. 39. A utility with a service company should, if operating efficiently, have lower costs per customer than a standalone utility, regardless of service company cost allocations. Thus, the Company, if operating efficiently, should have lower costs than utilities that do not have a service company relationship. Unfortunately for ratepayers, this is the not the case for Bay State. As demonstrated by Dr. Dismukes, no matter which way the apple is sliced, the Company is consistently a high cost company in all comparative groups.

Likewise, the Company makes the claim that structural accounting differences in individual service companies render comparisons between disaggregated accounts meaningless. Co. Br., p. 30. There is no factual support for this contention, and the Company's citations to Department Orders as support for this argument are not accurate. While the Orders discuss affiliate relationships, not one of them makes a finding implying that service company cost differences render comparisons between service companies and stand-along utilities meaningless. Even the Company's own witness Mr. Hevert could only suggest that accounting differences might exist stating, "[I]n *some* cases, companies *may* have different reporting conventions regarding specific cost categories." Exh. CMA/RBH-1, p. 28 (emphasis added). In short, the Company is simply grasping at straws in an effort to justify its high costs and gross inefficiencies.

In addition, the Company's rationale ignores the entirety of Dr. Dismukes' findings. Dr. Dismukes did not arrive at his conclusion that it was highly likely that the

Company's operating inefficiencies were leading to its inability to earn its authorized rate of return based on Bay State's underperformance compared to the "best performing company" in a single category of expense. Instead, Dr. Dismukes arrived at his conclusion because his analysis showed that the Company's total operating costs and the majority of subcategories were 22 and 29 percent higher than similarly-situated peer utilities when analyzed on a per-customer and per dekatherm basis. Dr. Dismukes found this metric to be even worse for the Company when compared against similar companies operating in Massachusetts, with the Company's total operating costs 66 and 112 percent higher than the average when analyzed on a per-customer and per dekatherm basis. Exh. AG/DED-1, pp. 78-81. Bay State's contentions that differences in account reporting conventions and service company cost allocations would render Dr. Dismukes' analysis useless are not supported by facts presented in the record.

Bay State also erred in claiming that Dr. Dismukes relied only upon EIA data. Co. Br., p. 29. The reference to the use of EIA data was only with respect to usage statistics and supplemental customer count information. Exh. AG/DED-1, pp.76-77. Rather than rely on a third-party provider of financial data, as Mr. Hevert's analysis does, Dr. Dismukes utilized each gas utility company's Annual Report filed with its respective public service commission(s). Exhs. AG/DED-1, pp.60-61 and AG/DED, p. 76.

Additionally, the Company makes several erroneous claims regarding alleged "mistakes" made by Dr. Dismukes.

Specifically, Bay State claims that at the hearing:

> Dr. Dismukes testified that mistakes in his data comparisons of utility costs were the result of the inability to get data from the Company, although all of his data for these comparisons allegedly came from EIA. This

> assertion was further disingenuous given that, under questioning, he conceded that the data groupings differed between his initial testimony and his rebuttal testimony, but the groupings could only have differed if the information was available to him but just put into different buckets in different iterations of his analysis.

Co. Br., p. 29, fn. 16 (citations omitted).

In fact, there were no mistakes in Dr. Dismukes' data comparisons. The differences between his rebuttal and direct testimony in terms of cost categories were the direct result of the Company's failure to provide in discovery the detailed cost data used by Mr. Hevert. Exh. AG/DED, p. 76. Dr. Dismukes specifically testified, that the Attorney General "asked the company three separate times to provide us with all the input . . . data for this study, and in each and every instance we did not get the data that we requested for each of the fields; and so we had to solve for this number based the on the response . . . we did have in relatively quick order." Tr. Vol. XIV, p. 1750

In summary, the Company's criticisms of Dr. Dismukes' analysis are nothing more than an obfuscation of the facts that clearly show Bay State's subpar cost performance. Therefore, because the Company's per unit operating costs are substantially higher than peer companies Bay State has significant opportunities to reduce costs and increase its achieved return on equity without the need for the TIRF or RY/RB mechanism.

5. THE DEPARTMENT SHOULD DISCONTINUE THE TIRF MECHANISM.

The Department should reject the Company's assertion that its replacement performance is superior since implementation of the TIRF. In making this argument the Company contends that it (i) has completed more TIRF-related investment in the years

2010 and 2011 than anticipated in D.P.U. 09-30; and (ii) was the beneficiary of capital funds over and above the "grassroots" capital budget as a result of the Department's decision to allow implementation of the TIRF. Co. Br., p. 24.

This is a misleading interpretation of the facts in the record. Rather than using an output measure of performance such as miles of leak-prone pipe replaced, the Company proposes that the Department judge its performance, based on dollars spent by the Company. Use of this faulty metric allows the Company to claim that it over-performed by more than 100 percent in 2011, because the Company's capital costs were 117.9 percent higher than forecasted in D.P.U. 09-30; yet miles of replaced pipe were 34.2 percent less than projected. Exh. AG/DED-Rebuttal-1. It is unreasonable to conclude that the purpose of the TIRF was simply to spend money without regard to results. In fact, the Company's poor performance strongly supports rejection of the current TIRF.

The Company's additional claim that its TIRF performance should be judged in light of the supposed fact that Bay State was "beneficiary of capital funds over and above the 'grassroots' capital budget" is absurd. Co. Br., p. 24. Nothing in the record in D.P.U. 09-30 conditioned, in any way, the Company's replacement rate on the capital markets or the estimated costs of the TIRF.

6. BAY STATE SHOULD BE HELD ACCOUNTABLE FOR OBTAINING PUBLIC BENEFITS FUNDED BY RATEPAYERS.

The Department should reject Bay States' suggestion that benchmarking metrics for pipeline replacement and leak reduction is not necessary. Specifically, the Company claims that the figures of 38 miles of mains and 1,839 services replaced annually are "average annual replacement levels that would have to be achieved to remain on pace with a program to eliminate the entire inventory of unprotected steel inventory over 15 years beginning in 2005." Co. Br., p. 34. Because of this, the Company claims that it does not constitute an appropriate minimum level that "could or should be achieved *each year*." *Id.* (emphasis added).

The Company's argument ignores the Department's intention to use the TIRF to bring about accelerated pipeline replacement efforts. In contravention of both the Department's intent and logic, Bay State actually decelerated its pipeline replacement efforts since the adoption of the TIRF. Therefore, the proposed pipeline replacement metrics are actually more generous to the Company than necessary, if the Company intends to "eliminate the entire inventory of unprotected steel inventory over 15 years." *Id.* Asking the Company to be held accountable to returning its pipeline replacement efforts to pre-TIRF levels is more remedial than punitive—the Company is currently off-track, but a set of reasonable benchmarks should enable it to implement the TIRF in the way it was intended.

7. RESPONSE TO CONSERVATION LAW FOUNDATION

In its Initial Brief, the Conservation Law Foundation ("CLF") asked that the Department support Bay State's proposed expansion of the existing TIRF program to include small-diameter cast-iron and wrought iron infrastructure. CLF argues that the public benefits of replacing aging infrastructure prone to leaks and ruptures include (i) less lost and unaccounted for gas, (ii) increased system reliability and safety, and (iii) positive environmental benefits from reduced emissions of methane, a potent greenhouse gas. CFL Br., pp. 2-4.

The Attorney General generally supports cost-effective efforts to replace aging system infrastructure for the exact reasons enumerated by the CLF; such actions provide many public benefits to utility customers stemming from increased system reliability and safety. However, the question before the Department is not a debate concerning the wisdom of system modernization; although the Company has tried numerous times to conflate of the RY/RB or expansion of the TIRF with the need for the Company to modernize its system. As shown by the Attorney General, the existing TIRF mechanism has had no discernible effect on the Company's infrastructure replacement rates, so there is no reason to believe the proposed expansions will deliver any of the additional public benefits asserted by the Company. Bay State, as a public utility, is obligated to provide safe and reliable gas distribution service with or without the existence of the TIRF mechanism. *See* D.P.U. 10-55, at 128-129. Therefore, the Attorney General requests that the Department deny the Company's proposed expansions to the TIRF mechanism and discontinue the existing mechanism for failure to perform in a fashion consistent with the expectations laid out by the Department in approving the mechanism in D.P.U. 09-30.

The CLF additionally notes that:

> It is important to acknowledge concerns about the ability of the TIRF program to reduce leaks cost-effectively on the system and to achieve real reductions in greenhouse gas emissions and lost and unaccounted for gas. To that end, CLF supports establishing targets by which the Department can measure the progress of the TIRF program.

CLF Br., p. 4.

If the Department authorizes some form of a TIRF, the Attorney General supports CLF's request that the Department set targets to measure the Company's progress to obtaining public benefits through the TIRF program. The Attorney General further requests that the Department establish enforcement mechanisms to hold Bay State accountable for obtaining these public benefits. The Attorney General submits that her proposed pipeline replacement targets of 38 miles of leak-prone mains and 1,839 miles of leak-prone services and her proposed leak reduction targets of reduced annual corrosion-related leaks by 5 percent per year are appropriate benchmarks for the Department to consider in benchmarking ongoing Company performance through its TIRF mechanism. Exh. AG/DED-1, pp. 3-4.

B. RATE BASE

1. PLANT IN SERVICE

In her Initial Brief, the Attorney General recommended the exclusion from rate base of two capital projects, new software for the Company's work order management system, and an upgraded phone system, because the Company did not demonstrate—as a factual matter—that the decision to proceed with these projects satisfied the Department's test for a prudent investment. AG Br., pp. 45-47. The Company claims that the Attorney General "fabricated standards" in her analysis, and therefore her arguments should be "dismissed." Co. Br., p. 55. This is not true. The Attorney General (AG Br., p. 45) and the Company (AG Br., p. 55) both agree that the controlling standard of review for plant in-service is initially the prudence test. Where the Company and Attorney General disagree is over the sufficiency of the facts produced by the Company on the record to carry its burden of proof to include these projects in rate base and consequently require customers to pay for them.[2]

[2] As stated by the Attorney General in her Brief:

> For the utility ***factually*** to satisfy the threshold test of the prudence of the decision to make rate base additions for non-discretionary or non-revenue generating plant, the Company must show that the existing equipment was no longer capable of providing service or that new equipment would pass a cost benefit test that demonstrates quantifiable benefits exceeds the cost of the new equipment.

AG. Br., p. 46 (emphasis added).

Under the prudence test, the Company's actions must be viewed in light of what it knew or reasonably should have known at the time the decision was made, and whether its actions where reasonable and prudent in light of those circumstances. *Fitchburg Gas & Electric Light Company*, D.T.E. 98-51, p. 12 (1998). This inquiry is fact-specific, and the recoverability of each project depends on an analysis of these known and knowable facts. The Company seems to be arguing in favor of a rote and generic management process, whereby the Company need only classify these disputed projects as non-revenue generating, describe what the project does, develop a budget and, having mechanically taken these steps, receive approval for rate recovery. Co. Br., pp. 56-58. However, the prudence standard requires more. Specifically, the Company must put on the record the known and knowable facts about the capital addition so the Department can evaluate its decision.

First, the Company's use of the moniker "non-revenue producing projects" is a misnomer, because once the projects are included in the cost of service used to set rates, they most certainly will produce revenue for the Company. Exh. AG ARN-1, p. 6. Indeed, as Attorney General witness Neale testified, "the term 'non-revenue' projects somehow does not seem an appropriate label since the installation of new plant that is included in rates either through a base rate case or via the TIRF or Modified TIRF will, by definition, generate revenue for the Company." *Id*. Notably, the Company did not dispute this statement on the record. In fact, if the project is replacing old and fully depreciated plant, it might be a very attractive investment for shareholders, and the Company should produce any analysis that it has performed on these types of capital investments so that the Department and the Attorney General can review the investment incentive signals produced by this category of projects. It has neither produced this information, nor confirmed that it exists.

Second, that the Company simply calls the upgrade to its phone and work order management projects "non-revenue generating" does not, by itself, entitle the Company to replace or improve it under the prudence test. If that were the case, then the Company would be free to add whatever capital it would like to rate base without any limits in the pursuit of improved—but unproved—unquantifiable benefits. By that logic, the Company could replace its fully serviceable crew trucks with a fleet of luxury SUVs simply by describing them as "method to transport crew to job sites." That would not contribute to least cost provision of distribution service, but would be acceptable under the Company's strained reading of the prudence standard because, according to the Company, it need not show that existing capital equipment no longer functions nor that the upgrades provide net savings. Co. Br., p. 56.

Third, the Company has not produced any documentation that could be called an internal study or analysis that supports its claims that either the existing phone system in the Springfield call center or the work order management system is failing to provide adequate service or that either replacement produces net benefits to customers in order to justify the costs. While the Company claims the new work order management system will avoid "costly maintenance," it has not provided analysis of these savings. There is no market testing of alternatives through requests for proposals to explore alternative solutions or test the price of the selected solutions. The Company notes that the upgrade to the work order management system "[d]elays large investment in new system development (i.e. Maximo) possibility 5 years or more". Exh. CMA/DAR 5 (workpapers), p. 56. But the Company fails to explain why it is more cost-effective for the Company to upgrade now ***and*** plan to buy a completely new system in a few years. Total capital costs would decrease by purchasing just one system, and not two, but the Company does not reveal the business case to justify this decision. The Company should have provided an analysis that shows spending now on the upgrade and also later on Maximo is, somehow, more cost effective than purchasing Maximo or some other more permanent software solution in 2011. It has not, and instead relies on generalities where concrete analysis should have been performed. In short, there is nothing beyond unquantified claims to savings and unsupported assertions of improved functionality to support these investment decisions. Having determined the Company has not meet its burden of proof, the Attorney General need not "contest" these issues any further, as the Company argues, in order to argue for exclusion of these projects from rate base. Co. Br., p. 57.

The Department should deduct $1,381,344 for the work order management system upgrade and $121,910 for the phone system reconfiguration. The Department should require the Company to (i) abandon the use of the term "non-revenue generating" plant as misleading, and instead require it to classify these types of capital projects as either replacement or improvement of plant no longer capable of providing service; or (ii) demonstrate that new equipment pass a cost benefit test that demonstrates quantifiable benefits exceed the cost of the new equipment.

2. THE COMPANY FAILED TO CORRECT ITS 2008 BALANCE OF ACCUMULATED DEFERRED INCOME TAXES

The Attorney General argued on brief that Bay State was imprudent for failing to inform the Department in D.P.U. 09-30 of a change in its estimated test year-end balance of accumulated deferred income taxes that was caused by a change in tax accounting for the test year in that case. AG Br., pp. 54-59. The Company responded by claiming that (i) the Department's precedent does not allow such "post-test year" adjustments to rate base; (ii) the change was recorded in 2009, and thus should not affect 2008 balances; and (iii) the Department had rejected similar modifications to rate base for tax modifications in the past.[3] Co. Br., pp. 59-63. All of these claims are not supported by the record evidence or Department precedent.

First, the correction that Bay State Gas should have made to the test year-end balance of accumulated deferred income taxes in D.P.U. 09-30 is not a post-test year end adjustment to rate base as the Company claims. The Department uses the test-year rate base to set base rates. In D.P.U. 09-30, the balance of plant, accumulated depreciation, customer advances, customer deposits, and unclaimed checks were all actual amounts as of December 31, 2008.[4] *See* D.P.U. 09-30, pp. 302 and 419. The balance of accumulated deferred income taxes for December 31, 2008, however, was necessarily an estimate, because the Company had not filed its tax returns for its tax year 2008 yet.[5] Tr. Vol. V., p. 591. The Company's request for a change in tax accounting changed its 2008 income taxes and the 2008 balance of accumulated deferred income taxes, not an amount associated with some other time. Thus, the correction to the balance of accumulated

[3] The Company also claims that customers were not harmed by its failure to fully disclose this refund, since it did not earn its allowed return on common equity during 2010 and 2011. Co. Br., pp. 41-42. As Mr. Newhard demonstrated, however, Bay State would be earning substantially more than its allowed return on common equity, if not for the harm that NiSource has inflicted upon the Company through its transactions with affiliates. Exh. AG/TN-1, pp. 3-9. The fact remains, however, that rates were set $6.6 million higher than they would have been had the Company corrected the balance of accumulated deferred income taxes as is required by Department precedent.

[4] The Department requires utilities to use the actual year-average balances of inventories, rather than year-end balances because those balances can fluctuate seasonally. *See* Exh. CMA/JTG-2, Sch. JTG-17.

[5] The Company is not required to file its federal income tax return until the third quarter of the year following the tax year, unless it gets filing extensions. *See* Exh. AG-1-87.

deferred income taxes was not a "post-test year adjustment" to rate base as the Company claims. It was a correction to an estimate that the Company was required by the Department. *Fitchburg Gas & Electric Light Company*, D.T.E. 02-24/25, pp. 32-33 (2002).

Second, Bay State's claim that it did not have to correct the 2008 balance of accumulated deferred income taxes because it chose to book the correction in 2009 cannot and should not determine the Department's right to demand corrections to test year-end balances. *Id*. The Department must use the most accurate information available for the test year to set rates. Furthermore, allowing the Company to use estimates in this fashion creates economic incentives for utilities to low-ball the estimate of its accumulated deferred income tax balance that it uses at test year end, and later correct to a higher number at some future date. This would set a terrible precedent that will disadvantage customers to the benefit of the utility shareholders.

Finally, the Company's citation to two other cases before the Department where income tax policy was uncertain do not provide support. Co. Br., pp. 61-63 (*citing New England Gas Company*, D.P.U. 10-114 and *National Grid*, D.P.U. 10-55). In both of those cases, the IRS treatment of such costs was uncertain and the IRS had not approved the change in policy for the utility in question. *Id.* None of that is true for Bay State in D.P.U. 09-30, where everything had already happened: the IRS had approved the tax accounting change and the tax refund was known and measureable. Therefore, those precedents do not apply to Bay State's approval for a change in tax accounting for 2008 and the necessary correction to the balance of accumulated deferred income taxes should have been made.

3. THE DEPARTMENT SHOULD ADJUST THE COMPANY'S BALANCE OF ACCUMULATED DEPRECIATION TO REFLECT THE HIGHER ACCRUAL RATES APPROVED BY THE DEPARTMENT.

The Attorney General argued on brief that the Company's balance of accumulated depreciation should be adjusted to reflect the depreciation accrual rates last approved by the Department, since the Company had already begun accruing depreciation expense during the test year at the lower rates it was proposing in this case.[6] AG Br., pp. 52-54. Bay State, in its brief, claims that the Company does not need a Department ruling before it makes an "accounting change" and that there is no basis for the assessment of a disallowance in this case. Co. Br., pp. 58-59.

The Attorney General agrees that Department approval may not be required by generally accepted accounting principles.[7] Indeed there may be no requirement for Department approval of any "accounting change" that the Company makes for financial reporting purposes. However, what the Company does for regulatory accounting purposes is entirely within the control of the Department. *See* 220 CMR 50.00 ("*Gas companies shall, on and after January 1, 1961, keep their books and accounts in accordance with the rules, definitions and instructions herein set forth and the Rules and Regulations of the Department*"). Certainly, for reporting purposes, and when establishing the rate base used to determine base rates, the Department can and should order a utility to conform with its regulatory accounting requirements, including the

[6] The Department last approved a change in the Company's depreciation accrual rates in its Order in D.T.E. 05-27, pp. 257-264.

[7] Although allowing Bay State Gas to use any depreciation accrual rate it wants for financial accounting purposes is possible, it would be advisable for the Department to order the Company to use the same depreciation accrual rates for financial and regulatory reporting purposes to eliminate the continual need for the conversions and translations of balance sheet and income statement information every time one wants to review and analyze the Company's current and historical information.

depreciation accrual rates and the associated balance of accumulated depreciation that it has found reasonable in the past. *Id.*

The approach taken by Bay State in this case allows it to game the regulatory process. If a utility can establish a higher depreciation accrual rate in its rate case proceeding, and then immediately adjust those rates downward after the rate case, again all within the range of reasonableness for accounting purposes, then the utility can unjustly enrich its shareholders all at the cost of its customers. Indeed, it is hard to find a case where a utility has ***increased*** its depreciation accrual rates for financial reporting purposes, before those rates were approved by the Department, since in all of those cases, shareholders would have been harmed and customers would have benefited. *See e.g.* D.T.E. 05-27, pp. 242-264 ("an increase of $4,714,746 to recognize the application of new accrual rates to year-end plant in service"); D.P.U. 92-111, pp. 116-126. ("the Company proposed an increase of $4,936,560 over the test year level"); D.P.U. 89-91, pp. and D.P.U. 777, p. 17 (the increase in depreciation accrual rate increased depreciation expense $400,000). The Company's failure to recognize the higher depreciation accrual rates from D.T.E. 05-27 on its books means that it will have overcharged customers for investment recovery, each and every month that those rates were in effect. Therefore, the Department should order the Company to restate its depreciation expense accruals for each and every month that it has used a different accrual rate from that ordered by the Department in D.T.E. 05-27.

C. REVENUES

1. ATTORNEY GENERAL'S REVENUE ADJUSTMENTS

The Company argues that the Attorney General's proposed adjustments to two categories of test year revenues, Special Contract revenues and Energy Products and Services ("EP&S") revenues are based upon adjusting the related test year levels for changes that will occur more than six months beyond the date of the order. In other words, beyond the mid-point of the rate year. The Company claims that these adjustments contradict Department precedent, citing to *Aquarion Water Company*, D.P.U. 11-43, p. 83 (2012) and *Boston Edison Company*, D.P.U. 85-266-A/271-A (1986). Co. Br. pp. 70-71.

These cases are easily distinguishable. The *Aquarion* case, although a recent decision, does not support the Company's argument. The Company's citation is to page 83 of the order, where the Department addresses payroll cost adjustments and not test year revenues. However, on pages 147-148 of the *Aquarion* decision, the Department does find adjustments that "reflect known and measurable wage increases occurring before the midpoint of the rate year" and are appropriate not because of precedent or Department policy, but rather because the methodology was consistent with what the Department had approved in the Company's last rate case.

The other citation is to a significantly older Order, which was decided more than 25 years ago, *Boston Edison Company*, D.P.U. 85-266-A/271-A. Here, the Department specifically states that a proposed payroll adjustment was not sufficiently supported for the Department to alter its practice of annualizing "those rate increases which occur within six months after the issuance of the Department's rate order." Again this citation also deals with a payroll expense—not revenues related to non-tariffed services.[8]

The Company fails to address or refute Department precedent cited in the Attorney General's Initial Brief that specifically addresses non-tariffed rate revenues. In *National Grid*, DPU 10-55, the Department clearly states that it requires known rate changes be included in determination of the revenue requirements for tariffed rate services. Consider

> post-test year increases in special contract revenues may result from an increase in the rate charged under a specific contract, as opposed to a change in load. See, e.g., D.T.E. 05-27, at 59-60. In such circumstances, the Department has approved post-test year adjustments to special contract revenues resulting from known and measurable changes in contract pricing terms. See D.T.E. 05-27, at 59-60.

National Grid, DPU 10-55, p. 231.

The Company has not disputed the calculation of the Attorney General's proposed adjustment and has not provided any compelling arguments that might persuade the Department to reject the proffered revenue adjustments. Therefore the Department should accept the adjustments to Special Contract revenues and EP&S revenues as proposed by the Attorney General. AG Br., pp. 62-64.

[8] The distinction is made here between tariffed revenues which are revenues from customers where the rates are established as part of the rate case and are based on the alignment of costs and revenues, and revenues from customers whose rates are not established in the rate case. The non-tariffed rate revenues, specifically the revenues from special contract customers and EP&S customers, exist primarily to provide benefits of lower costs to serve the monopoly service customers that are served under cost based tariffs.

D. OPERATIONS AND MAINTENANCE EXPENSES

1. THE COMPANY'S TEST YEAR COST OF SERVICE IS HIGHER AS A RESULT OF THE SALE OF NORTHERN UTILITIES.

a) The Proper Measure of the Impact of the Northern Sale On Customers is the Loss Of Northern's Contribution Minus the Cost Savings From the Sale of Northern.

In the conclusion to its analysis and findings on the issue of the effect of the sale of Northern Utilities ("Northern") on the Company's cost of service in D.P.U. 09-30, the Department stated that:

> we conclude that Bay State should seek to mitigate costs associated with the sale of Northern, and then should be able to absorb any remaining costs. In making this decision, we note that in D.P.U. 08-43-A, the Company conceded that even the maximum estimated cost impact of $5.14 million is an "insignificant" cost variance. D.P.U. 08-43-A at 34.

D.P.U. 09-30, p. 281.

The Company now states that pursuant to the Department order in D.P.U. 09-30, "the Company was not required to 'fully' mitigate – or completely off set – the impact of the Northern sale on Bay State's costs." Co. Br., p. 235. The Company is, of course, correct. The Department did not require the Company to "fully"' mitigate the impact of the Northern sale on Bay State's costs. However, the Department did find that to the extent that the Company was unable to mitigate costs associated with the sale of Northern, the Company "should be able to absorb any remaining costs." That is, the Company's customers should be held harmless from any residual costs associated with the sale of Northern that the Company was not able to mitigate.

In D.P.U. 09-30, the net increase to the Company's expenses from the loss of Northern's contribution to those expenses was calculated at $2,710,000. The savings expected due to the sale of Northern were estimated at $750,000. Thus, the costs associated with the sale of Northern that the Company was not able to mitigate were $1,960,000. The Department determined that customers should be held harmless from this increase to the Company's expenses.

The Department's findings in D.P.U. 09-30 were clear: (i) the Company should absorb any costs associated with the sale of Northern that it was not able to mitigate; and (ii) the measure of the unmitigated costs is the loss of Northern's contribution minus the cost savings from the sale of Northern. The Company now acknowledges that "[a]n examination of the schedules prepared by Mr. Simpson demonstrates that he did not prepare a calculation to show the difference between foregone revenues from Northern Utilities and cost mitigation savings." Co. Br., p. 235. In a footnote Bay State asserts that "the Company did prepare a calculation of the Company's version of the difference between foregone Northern revenues and cost mitigation savings" (*Id*.), although the Company then fails to identify where the "Company's version" is presented and the Company later describes such a calculation as "irrelevant." Co. Br., p. 240.

In other words, Mr. Simpson made no attempt to replicate the Department's formulation for measuring the increase in costs from the sale of Northern that the Company was unable to mitigate. It is critical to note that the formula for measuring the residual effect on costs to the Company from the sale of Northern was determined by the Department, not the Attorney General. Thus, when the Company states that "it is not appropriate to compare cost mitigation savings to the foregone Northern revenues" (Co. Br., p. 237), it is dismissing the Department's decision in D.P.U. 09-30, not simply disagreeing with the Attorney General's approach in this case.

The Company also states that "the fact that the Attorney General calculates the difference between the loss of Northern's Management Fee contribution and cost mitigation savings to determine if the loss of Northern's Management Fee contribution has been fully mitigated is unsupported and without merit." Co. Br., p. 239. Yet, in this regard, the Attorney General's method exactly replicates what the Department did in D.P.U. 09-30, and the Company does not argue otherwise.

The Company also criticizes Mr. Effron's adjustment to restate the lost contribution from Northern from 2008 dollars to 2011 dollars. However this adjustment is also necessary to get a proper "apples to apples" comparison. That is, all the savings are stated in 2011 dollars, so the lost contribution from Northern must also be stated in 2011 dollars. From the Company's perspective, it is ultimately irrelevant whether the lost contribution from Northern is stated in 2008 dollars or 2011 dollars because the Company believes that it is inappropriate to compare the achieved savings to the lost contribution from Northern. Rather, we are told the "the actual standard [is] that the Company must mitigate the foregone Management Fee revenues to the greatest extent possible." Co. Br., p. 240. This subjective criterion (which, in any event, is virtually impossible to verify) might be the Company's preferred standard, but this is not the standard adopted by the Department in D.P.U. 09-30.

b) Criteria Established By the Department Preclude the Recognition of Much of the Cost Savings Being Claimed By the Company.

The Attorney General's Initial Brief stated that:

> There are two basic elements, or criteria, to the Department's finding that the Company "should seek to mitigate costs associated with the sale of Northern" if the cost mitigation is to be counted against the incremental expenses incurred

> by CMA as result of the disposition of Northern: First, there should be identifiable practices implemented by the Company in its efforts to mitigate costs. Second, such mitigation of costs should have some proximate association with the sale of Northern. The great majority of savings claimed in the Company's presentation are devoid of both these basic elements.

AG Br., p.71.

The Company argues that "neither criteria (sic) is derived from the Department's directives in D.P.U. 09-30." Co. Br., p. 241. However, both of these criteria derive directly from the Department's findings in D.P.U. 09-30. When the Department stated that the Company "should seek to mitigate costs," that can only be interpreted to mean that the Company should seek to implement practices that would mitigate costs. If the Company could not identify any such practices, then what reason is there to believe that practices to mitigate costs had been implemented? In fact, what follows in the Company's brief is not any explanation of why this criterion was not derived from the Department's directives in D.P.U. 09-30, but rather a circular and self-serving justification of why Mr. Simpson did not find it necessary to identify the implementation of any cost saving processes in the relevant cost centers. If any cost mitigation is to be counted against the incremental expenses incurred by Bay State as result of the disposition of Northern, then it is only reasonable that Company identify practices that were implemented to achieve such cost mitigation. As the Department noted in D.P.U. 09-30, in citing its findings from D.P.U. 08-43-A, "we expected Bay State to address any measures to mitigate the potential increase in its overhead expenses in its next base rate proceeding." D.P.U. 09-30, p. 279.

With regard to the second criterion, the Company does not dispute that in D.P.U. 09-30 that the Department found that the Company "should seek to mitigate costs associated with the sale of Northern." Evidently, though, there is something about the term "associated with the sale of Northern" that the Company doesn't understand, because it now argues that it is not necessary that cost mitigation (if any) has any relationship to the sale of Northern to be included in its analysis. To justify its failure to link certain of its claimed cost savings to the sale of Northern in any way, the Company relies on the Department's statement on page 279 of the Order in D.P.U. 09-30 that it expected the Company to "to explore any and all measures that provide the opportunity for cost savings." Co. Br., p. 242. What the Company neglects to mention, however, is that the Department was recapping its own findings from D.P.U. 08-43-A as predicate for its findings in D.P.U. 09-30. The Department went on to find that "it is inequitable that ratepayers should be required to bear the burden of **the Company's estimated costs related to the sale of Northern at this time**." D.P.U. 09-30, p. 281. (emphasis added). The Department's focus was clearly on "costs related to the sale of Northern," and that is what the Company must be required to mitigate.

c) The Comparison Of The Savings Quantified By The Attorney General In The Present Case To The Savings Quantified By The Company In D.P.U. 09-30 Is Valid As A Reasonability Check.

The Company contends that: "[i]n effect the Attorney General is arguing that her estimate of cost mitigation savings is more accurate than the Company's because it is closer to the estimate that Concentric prepared in the Company's 2009 rate case." Co. Br., p. 244. This contention is not supported by the record. The Attorney General is arguing that her estimate of cost mitigation savings is more accurate than the Company's because the Company's estimates of cost savings were: (i) unreasonably inflated by the application of unsupportable workload and activity adjustment factors; (ii) totally unrelated to the sale of Northern; and (iii) not based on identifiable practices that were implemented to achieve the cost savings.

The comparisons to the estimate that Concentric prepared in the Company's 2009 rate case were simply included as reasonability checks. The Attorney General's quantification of savings easily passed these reasonability checks, because in all cases where the comparison was applicable, the savings quantified by the Attorney General were significantly greater than the estimates that Concentric prepared in the Company's 2009 rate case, in circumstances where it was not in the Company's interest to inflate estimates of the cost savings.

d) The Company's Estimate Of Cost Savings In the Call Center Is Substantially Overstated.

The Attorney General identified three problems with the Company's quantification of cost savings in the Call Center: (i) application of a 19% activity adjustment factor to the total Call Center labor expense (non-phone activity as well as phone activity) exclusive of supervisory and overtime labor; (ii) failure to link any cost savings to the sale of Northern in any way; and (iii) failure to describe or quantify any Call Center cost mitigation efforts undertaken by Bay State following the sale of Northern.

The Company attempts to explain away each of the problems in its initial brief. With regard to the first problem identified by Mr. Effron, Bay State states that "Mr. Simpson explained that he used the increase in the AHT to quantify the increase in non-phone activities because Bay State does not have a quantitative measure of non-phone." Co. Br., p. 248. In other words, the Company is using the inadequacy of its available information as a defense of a method that is otherwise indefensible. However, the fact that the Company does not have a measure of non-phone activity does not mean that non-phone activity increased at the same rate as phone activity. The Company goes on to dismiss the Attorney General's criticism of the Company's analysis for not providing any data supporting the increase in non-phone activity, but does not elaborate on why an expectation of data to support the claimed increase in non-phone activity is a false criterion.

With regard to the second problem identified by the Attorney General, Bay State claims that "there is no support or justification for excluding cost reduction initiatives that cannot be tied directly and exclusively to the sale of Northern." *Id*. The Company's failure goes well beyond that. The Company did not show that its cost savings were *in any way* tied even indirectly, or even remotely, to the sale of Northern. In a footnote to this claim, the Company asserts that rather its "analysis focuses on savings related to the Company's efforts to realign operations in the functional areas that formerly provided services on a shared basis to both Bay State customers and Northern customers after the sale of Northern." *Id*. This brings us to the third problem with the Company's analysis.

If the Company's analysis focused on savings related to its efforts to realign operations in the functional areas that formerly provided services on a shared basis to both Bay State customers and Northern customers after the sale of Northern, then how is it possible that the Company was unable to identify **any** such efforts to realign operations in the Call Center? On the one hand the Company claims that its analysis focused on savings related to the Company's efforts to realign operations, but then on the other (just one page later) the Company states "there is no reason exclude cost mitigation savings because Concentric did not identify specific cost mitigation efforts." Co. Br., p. 249. If the Company is going to claim savings from "efforts to realign operations" it is reasonable to expect at least a description of what those efforts were.

e) The Company's Estimate of Revenue Recovery Cost Savings Is Substantially Overstated.

The Attorney General identified three problems with the Company's quantification of cost savings in the Revenue Recovery cost center: (i) application of a 72% workload adjustment factor to the Revenue Recovery labor expense because the 72% factor gave equal weight to all the Revenue Recovery activities; (ii) failure to link any cost savings to the sale of Northern in any way; and (iii) failure to describe or quantify any Revenue Recovery cost mitigation efforts undertaken by Bay State following the sale of Northern.

With regard to the first problem identified by the Attorney General, the Company does not even attempt to explain or defend Mr. Simpson's assignment of equal weights to each of the five primary activities in the Revenue Recovery cost center. Indeed, there is no plausible defense for an analysis that assumes that the time associated with a bankruptcy is the same as the time associated with managing a single customer in the fuel assistance program. Instead, the Company justifies Mr. Simpson's analysis on the grounds that "Concentric evaluated several alternative reasonable indexes, which provided results that are very similar to the Revenue Recovery workload adjustment factor that Concentric prepared and used to calculate Revenue Recovery cost mitigation savings." Co. Br., p. 252. Mr. Effron addressed the "alternative indexes" (which are **not** reasonable) in his rebuttal testimony:

> I infer from Mr. Simpson's description that the rejected alternative would have weighted the percentage increase in the Arrearage Management Program equally with the percentage increases in the other Revenue Recovery activities. Because the Arrearage Management Program started from such a low base in 2008, the percentage increase from 2008 to 2011 was 1,049% (Exhibit CMA/JDS-Rebuttal-1, at 31). Obviously, weighting this percentage increase equally with the percentage increases in the other Revenue Recovery activities would have resulted in a wildly distorted measure of workload increase for the whole cost center. However, this does not justify using the less distorted but still problematic workload index that Mr. Simpson presented in his direct testimony.

Exh. AG-DJE-Rebuttal-1, at 13-14

In short, the Company has failed to justify Mr. Simpson's equal weighting of the five primary activities in the calculation of the 72% workload adjustment factor.

With regard to the second two problems cited by the Attorney General, the Company replicates its arguments regarding the Attorney General's criticisms of the Company's analysis of Call Center cost savings. The Company's arguments here have no more validity than they do in the Call Center section of the Company's initial brief.

f) The Company Has Not Established Any Savings In Regulatory Affairs.

The Company has not established that there has been any Regulatory Affairs cost mitigation associated with the sale of Northern. As noted in the Attorney General's initial brief, Mr. Simpson has provided no data or quantitative analysis to support his claim that the Company needed the two additional employees for the supposed increase in Regulatory Affairs workload. The Company asserts that the Attorney General's criticism of the Company's analysis for failing to provide supporting data or qualitative analysis is “yet another example of a false criteria (sic) that the Attorney General has created.” Co. Br., p. 255.

Again, if the Company is asking the Department to accept its estimate of the cost savings in Regulatory Affairs from the sale of Northern, it is reasonable to expect the Company to be able to quantify, or even to estimate, the actual reduction to the Regulatory Costs associated with the sale of Northern. The so-called “substantial qualitative supporting information” (*id*.) presented by the Company is nothing more than Mr. Simpson’s own subjective opinion of the Regulatory Affairs cost savings. Mr. Simpson also failed to describe or quantify cost mitigation efforts undertaken by Bay State following the sale of Northern. The Company claims that it had to rely on its qualitative analysis because “meaningful measures of Regulatory Affairs’ workloads is not measured or recorded. “ *Id*., fn. 58. Again, the Company is using the inadequacy of its available information as a defense of a method that is otherwise indefensible. However, the fact that the Company does not have meaningful measures of Regulatory Affairs’ workloads does not justify Mr. Simpson’s failure to offer any objective quantification of Regulatory Affairs cost savings. The Company has not shown any cost savings in the Regulatory Affairs cost center, and none should be included in the analysis.

g) Any Savings In Corporate Services Are Not Attributable To The Northern Sale.

The final area of disagreement in the Company’s analysis of savings is in the area of Corporate Services. The savings in this area derive from the transfer of Gas Supply and Control functions to Columbus, Ohio. These savings are not attributable to the sale of Northern. In its brief, the Company offers the unsupported assertion that “[t]he transfer occurred because the unique operational and regulatory issues associated with

Maine and New Hampshire had been eliminated by the sale of Northern." Co. Br., p. 257. In fact, there is absolutely no evidence whatsoever that the transfer occurred **because** operational and regulatory issues associated with Maine and New Hampshire had been eliminated by the sale of Northern, and the Company cites none. The evidence shows that the savings associated with Corporate Services provided to Bay State are not directly attributable to the sale of Northern, but rather that the sale of Northern merely simplified the transfer of Gas Supply and Control to Columbus. Exh. AG 3-31.

There is no evidence that the transfer of Gas Supply and Control to Columbus would not have taken place in the absence of the sale of Northern. If there are reductions to costs that would have taken place completely irrespective of the sale of Northern, then such reductions should not be counted as cost mitigation resulting from the sale of Northern.

h) Summary.

In D.P.U. 09-30, the measure of the unmitigated costs was the loss of Northern's contribution minus the cost savings from the sale of Northern. In the present case, the Company attempts to establish a whole new standard for determining whether any adjustment to the cost of service is necessary to hold customers harmless from the effect of the Northern sale. Under the Company's preferred framework, it simply has to make a claim of cost mitigation and put some numbers to that claim, irrespective of whether the mitigation is adequate to offset the loss of the contribution from Northern, irrespective of whether the mitigation has any relationship to the sale of Northern, and irrespective of whether the Company is able to identify any actual cost mitigation efforts - and then no adjustment to the cost of service is necessary to hold customers harmless. However, if customers are to be held harmless from the sale of Northern under the standards established by the Department in D.P.U. 08-43-A and D.P.U. 09-30, the cost mitigation must be at least equal to the lost contribution from Northern, must bear at least some relationship to the sale of Northern, and must be the result of actual cost mitigation efforts. It is not the position of the Attorney General that there has been no cost mitigation as the result of the sale of Northern. In fact, the Attorney General has agreed that there have been cost savings substantially in excess of what the Company itself quantified in D.P.U. 09-30. However, those cost savings have not been sufficient to offset the loss of the contribution from Northern. If ratepayers are to be held harmless from the sale of Northern, the Company's pro forma test year cost of service must be reduced by $1,679,000, as put forth in the Attorney General's initial brief.

2. NISOURCE CORPORATE SERVICE COMPANY CHARGES ARE UNREASONABLE

The Attorney General's Initial Brief demonstrated that the $40 million in charges for administrative services from the Company's affiliate NiSource Corporate Service Company ("NCSC") have exploded in magnitude, growing by more than 36.7 percent, or $10.9 million, in the last three years since Bay State's last base rate case, while the services received for those charges have remained similar. AG Br., pp. 87-90. This has partially caused the Company to be the high cost provider of such services for gas distribution companies in Massachusetts. *Id*. (*citing* Exh. AG/DED-1, pp. 79, 81, Sch. DED-26, p. 7 and Sch. DED-27, p. 7). As a result, the Department should reject the increase in the NCSC charges and limit any increases to the rate of inflation during the last three years. *Id*.

The Company argues on brief that (i) it met its burden of proof for recovery by providing all of the costs and allocation factors; (ii) the Attorney General failed to provide any rationale for denying recovery of costs; and (iii) a study Bay State had performed (the "Baryenbruch study," see RR-AG-4) provides proof that the Service Company charges are reasonable. Co. Br., pp. 39-42. As will be discussed below, all of the Company's claims are unsupported.

The fact that the Company can add up all of the charges that are derived from the Service Company to $40 million does not mean that those $40 million costs were prudently incurred, nor appropriately charged to Bay State. *Fitchburg Gas and Electric Light Company*, D.T.E. 99-118, p. 7, n.5 (2001) (the Company bears the burden of proving each and every element of its case by a preponderance of "such evidence as a reasonable mind might accept as adequate to support a conclusion"). Simply providing charts of the allocation factors and the amounts billed by the Service Company does not mean that the underlying amounts were prudently incurred, nor does it mean that the direct charges and the allocations to the Company are just and reasonable. *Id*. There is no description of the specific reasons for or the causes of the $10.9 million increase in charges. Thus, the Department can reject the increase for this reason alone. *Id*.

The evidentiary record, however, provides a very specific reason for the increase in costs that has been identified—the transfer of employees from other operating companies in the NiSource system to the Service Company. *See* AG Br., p. 89 (citing Exh. AG-1-44). Because the Service Company is not supposed to make a profit nor take a loss, all of the costs of NCSC, including employee costs, are either directly assigned or allocated to the operating companies, regardless of whether there is any benefit provided by any individual employee or the associated overhead.[9] The transfer of these employees from the operating companies caused the employee levels and payroll at the Service Company to swell by over 37.5 percent in the last three years, comparable to the 36.7 percent increase in Service Company charges to Bay State. *Id*. (citing Exh. AG-1-44, pp. 3-4). The cause for the increases in Service Company charges could not be clearer.

Finally, the study that the Company uses to support the reasonableness of the Service Company's charges—the Baryenbruch study—should be rejected by the Department. While there is no evidence in the record as to the education or the expertise of the authors of the study, it is clear that their study, in this instance, is totally unreliable. First, in order to determine the reasonableness of the Service Company's charges, the study uses a group that is almost exclusively comprised of electric companies. AG-RR-4, pp. 12-13. While that comparison might appear to be a reasonable proxy for a gas distribution company on its face, it is not. Indeed, because most of these electric companies are vertically integrated, with transmission and generation businesses added to the distribution business, the service company costs for those firms will naturally be higher than those of a simple gas distribution company like Bay State. (*see e.g*. Southern Company, Exelon, Duke, and Entergy). *Id*. These extra costs incurred by electric companies associated with supporting these other activities cause the Service Company charges for Bay State to appear to be much better than they are, due to the fact that the study's analysis is done on a customer basis. Second, the Company congratulates itself because the study found that the Service Company costs are less than those of outside

[9] Indeed, all Service Company costs are charged out to the operating companies, including employees' non-productive time. Therefore, even though Service Company direct charges to Bay State Gas increase by 23.1 percent over the three years, allocated costs, including those of all its 367 new employees, increased by more than 83.3 percent or $5.6 million. *See* AG Br., pp. 88-89.

services, including the lawyers on its legal staff costing less than $311 per hour, accountants on its staff costing less than $148 per hour, staff engineers costing less than $103 per hour, and other employees costing less than $270 per hour for "management consult services." *Id*., pp. 15-28. If the Company considers these purported savings to be achievements, it has set the bar exceedingly low.

Ultimately, the Company has not supported the increase in the Service Company charges that customers are being asked to pay for in this case. *Fitchburg Gas and Electric Light Company*, D.T.E. 99-118, p. 7, n. 5 (2001). The extra costs are clearly the result of an unnecessary, unreasonable increase in the employee numbers at the Service Company that provide no discernable benefit to Bay State customers. Therefore, the Department should reduce the cost of service by $6 million. Exh. AG/TN-1, pp. 7-9.

3. ABNORMAL AND NON-RECURRING EP&S WRITE-OFFS IN 2009 AND IN OCTOBER 2011 MUST BE ELIMINATED FROM THE DETERMINATION OF THE NORMAL EP&S WRITE-OFF RATIO.

Bay State makes no attempt to establish that the write-off experience for EP&S in 2009 and October 2011 are normal and reasonably representative of the conditions that the Company is likely to experience prospectively. It is undisputed that the services to which the 2009 write-offs relate—Furnace Boiler Installs, House Heater Repairs and Annual Inspections—have either been eliminated or significantly reduced. Exh. AG 3-9. In response, the Company claims that "[t]he development of a charge-off to revenue experience factor should not be impacted by increasing or declining revenues." Co. Br., p. 107. However, if the services being eliminated or reduced had led to higher than normal charge-offs, obviously their elimination or reduction would reduce the charge-offs as a percentage of revenues. Accordingly, the non-recurring write-offs associated with services reduced or eliminated since 2009 should not be included in the determination of the normalized, prospective write-off rate.

The Company does not even address the write-off of Residential Guardian Care receivables recorded in October 2011 as a result of the policy change in that year. This clearly is not a normal, recurring event that the Company will experience prospectively. The write-offs recorded in October 2011 should also be eliminated from the determination of the normalized write-off rate.

The Company states that "[i]f the practice is to eliminate any year out of the three that is higher than the other two, then the purpose of employing a three-year average to smooth the inevitable fluctuations experienced during a particular year will be rendered meaningless." Co. Br., p. 107. However, the proposal here is not to eliminate 2009 from the determination of the write-off percentage applicable to EP&S revenues simply because the percentage was higher in that year than it was in the other two. If it were, the Attorney General would have also proposed to eliminate 2009 from the determination of the write-off percentage for non-gas base rate revenues. The year 2009, and also October 2011, should be eliminated from the determination of the write-off percentage applicable to EP&S revenues because those periods included unusual, non-recurring charges that distort the calculation of the average to be used to calculate the normal, prospective write-off percentage.

The circumstances in the present case, while not identical to those in D.P.U. 09-30, also warrant departure from the strict use of a three-year average to determine bad debt expense applicable to EP&S revenues. The Department should treat the abnormal and non-recurring charges recorded in 2009 and October 2011 as it did write-offs attributable to prior years in D.P.U. 09-30.

4. THE AMORTIZATION OF THE MASSACHUSETTS FRANCHISE TAX LOSS SHOULD BE ELIMINATED FROM THE COMPANY'S REVENUE REQUIREMENT.

In its Initial Brief, the Company claims that "the Company **has already included the ADIT** [related to the income tax deductions disallowed for Massachusetts franchise tax purposes] **as a rate-base deduction**." Co. Br., p. 113 (emphasis in original). However, in Exhibit CMA/JTG-Rebuttal-2, while the state deferred income taxes includes the effect of the tax deductions in question, there is also an offsetting entry that has the effect of eliminating those deferred state income taxes (net of federal income taxes) from the balance of deferred taxes that is actually deducted from plant in service in the determination of rate base. In other words, the Company's rate base has, in effect, been presented as if there were no disallowed depreciation expense for the purpose of the Franchise Tax. To be consistent, the income tax statement should not include an amortization of the tax loss.

In its brief, the Company incorrectly claims that "[n]ow on brief, the Attorney General asserts that the tax deduction treatment is inappropriate as the Company's rate base did not reflect a related depreciation expense (Att. Gen. In. Br. at 121)." Co. Br., p. 115. The Attorney General made no such assertion and the Company's nonsensical claim should be disregarded. The amortization of the Massachusetts franchise tax should be eliminated from the pro forma income tax expense to be consistent with Company's rate base treatment of the related deferred taxes.

5. THE COMPANY HAS NOT ESTABLISHED ACCOUNT 128 INCLUDES HEEL GAS THAT IS APPROPRIATELY INCLUDABLE IN ITS RATE BASE.

In its Initial Brief the Company explains why Heel Gas should be included in rate base. Co. Br., pp. 45-46. However, what the Company is actually proposing is to include in rate base is Special Fund - Account 128. Bay State has not established that Special Fund - Account 128 includes Heel Gas. Therefore, this item should be eliminated from the Company's rate base.

6. UNCOLLECTIBLE ACCOUNTS EXPENSES SHOULD BE EXCLUDED FROM THE EXPENSE LEAD COMPONENT OF THE CASH WORKING CAPITAL REQUIREMENT, WITH NO ADJUSTMENT TO THE REVENUE LAG.

The Company asserts that "if the Department chooses to adopt the Attorney General's recommendation to exclude uncollectibles from the calculation of the net lead component, then the Department must adjust the revenue lag calculation as well." Co. Br., p. 68. Mr. Effron explained in his rebuttal testimony why no adjustment to the revenue lag is necessary if the uncollectible accounts expense is removed from the expenses included in the lead-lag study: The removal of uncollectible accounts from the calculation of the revenue lag "is necessary because otherwise the calculation of Accounts Receivable turnover would include balances that are never collected, and this would clearly be inappropriate. However, the method used to calculate the Accounts Receivable turnover does not change the fact that the uncollectible expense is a non-cash expense. Exh. AG-DJE-Rebuttal-1, p. 6. Accordingly, the uncollectible accounts should be removed from the lead-lag study, and there should be no modification to the calculation of the revenue lag.

7. AIRCRAFT COSTS.

The Company claims that the "Attorney General does not provide any Department precedent to support a new policy standard related to capping costs" of its executive travel. Co. Br., p. 118. Bay State maintains that flying across the country in a Hawker 800XP executive jet and other executive jets, at a cost of $6,354 per person per flight, is an "entirely valid business expense." Co. Br., p. 119. The Company states that since the Department allowed recovery in D.T.E. 05-27, that it is entitled to recovery in this case.[10]

It has long been Department precedent "that ratepayers should not have 'to support the lavish personal preferences of utility executives'." *Fall River Gas Company*, D.P.U. 750, p. 15 (1981) (disallowing recovery of a Buick Le Sabre and Oldsmobile Delta 88 as excessive[11]). In a more analogous case, one in which the utility also maintained that its "financial condition has been imperiled," the Department disallowed the recovery of expenses related to a yacht on the basis that it was a "luxurious indulgence." *Lowell Gas Company*, D.P.U. 18571/18572, pp. 12-13 (1976). Like the yacht, the use of executive jets is a "luxurious indulgence" for a utility that claims it "cannot reduce its operating costs to the point necessary to achieve its authorized rate of return. . . ." Co. Br., p. 26.

While the Company claims that the "Attorney General does not provide any Department precedent to support a new policy standard related to capping costs," it omits the fact that the Department's usual practice is to exclude 100 percent of these types of

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[10] The Department indicated that the Attorney General did not properly quantify the costs in D.T.E. 05-27, but she has done so in this docket.

[11] The Hawker 800 is a significant upgrade over a Buick. http://www.youtube.com/watch?v=qe2Qzs75fqA

lavish expenses. However, the Attorney General recognizes that Bay State is now part of the NiSource holding company and that there may be legitimate transportation costs for executives traveling to its headquarters in Indiana and Ohio. Therefore, the Attorney General has recommended that the cost of airfare be limited to coach service for airplane flights. While the executives may dislike this limitation, it is consistent with the positions taken by other Public Utilities Commissions who regulate affiliates of public utility holding companies operating in Massachusetts. For example, in regards to NSTAR and Western Massachusetts Electric Company affiliate Connecticut Light & Power Company, the Connecticut Department of Public Utility Control limited travel expense for executives to a proxy cost that equaled the costs of "public transportation." *Connecticut Light & Power Company*, Docket No. 03-07-02, p. 74, 229 PUR4th 380 (2003). Indeed, even if the cost per person per round trip were as much as $1,000 per trip, the cost would have been $18,000 rather than the $114,371 the Company is requesting. AG Br., p. 121.

Therefore, the Attorney General requests that the Department limit recovery of airplane travel. Customers should only be required to reimburse the Company for coach service for airplane flights.

8. THE DEPARTMENT SHOULD DISALLOW ALL POST-TEST YEAR NON-UNION PAYROLL INCREASES.

The Attorney General demonstrated, and Bay State agreed that, although the Company claimed that it met all of the Department's requirements for post-test year non-union payroll increases in its last base rate case in D.P.U. 09-30, it had in fact not met two of them: (i) granting permanent 2009 increases (when the increase was actually only a one-time payout for significant numbers of employees), and (ii) granting the 2010 increase before the midpoint of the rate year (when the increase actually came after the midpoint of the rate year).[12] AG Br., pp. 94-98. (*citing Fitchburg Gas & Electric Light Company*, D.P.U. 1270/1414, p. 14 (1983) and *Boston Edison Company*, D.P.U. 85-266-A/271-A, p. 107 (1986)). As a result, the Attorney General recommends that the Department deny all post-test year non-union payroll increases in this case, and until such time as the Company can demonstrate a historical pattern of commitment to such increases. *Id.* While the Company agrees with the facts about its failure to commit to the proposed increases in D.P.U. 09-30, it states that the harm to customers was smaller than the amount calculated by the Attorney General, and that the Company didn't earn its allowed return during the time that rates from D.P.U. 09-30 were in effect, and therefore, there is no reason for concern, because it's all part of the ebb and flow of cost changes. Co. Br., pp. 83-86.

The fact remains that regardless of the dollar amount involved, the Department would have denied these proposed non-union payroll increases had the Company been more forthcoming during the proceedings in D.P.U. 09-30.[13] *Fitchburg Gas & Electric Light Company*, D.P.U. 1270/1414, p. 14 (1983) and *Boston Edison Company*, D.P.U. 85-266-A/271-A, p. 107 (1986). The base rates set by the Department in D.P.U. 09-30 would have been almost a million dollars less had there been more candor on the part of

[12] The Department permits such adjustments when a company demonstrates that: (1) the proposed increase is a reasonable amount; (2) there is an express commitment by management to grant non-union increase; and (3) there has been a historical correlation between non-union and union increases. *Fitchburg Gas & Electric Light Company*, D.P.U. 1270/1414, p. 14 (1983). The Department has found that that testimony on the record by one of a company's most senior officers satisfies the requirement of a demonstration and express commitment to grant prospective payroll increases. *Boston Gas Company*, D.P.U. 93-60 p. 95 (1992). In addition, only non-union salary increases that are scheduled to become effective no later than six months after the date of the Order may be included in rates. *Boston Edison Company*, D.P.U. 85-266-A/271-A, p. 107 (1986).

[13] The Attorney General recognizes that the amount of the harm associated with the 2009 non-union payroll increase may have been somewhat smaller, although the Company provides no evidence to support the many calculations that it supplies on brief for a smaller number.

the Company. AG Br., pp. 94-98. Therefore, the Department should deny all of the Company's post-test year non-union payroll increases.

9. RATE CASE EXPENSE.

The Company's arguments in its Initial Brief in opposition to the Attorney General's request to disallow and limit certain of the Company's rate case expenses are without merit and the Department should deny the Company's request to collect these expenses from ratepayers.

As set forth in the Attorney General's Initial Brief, the Company failed to issue RFPs for three out of five of its outside consultants and in none of those instances could the Company meet its burden to prove "most unusual of circumstances" that adequately justified the Company's departure from the norm of the competitive bidding process under Department precedent. AG Br., pp. 103–12; *see also* Co. Br., p. 96 ("[i]n all but the most unusual of circumstances, it is reasonable to expect that a company can comply with the competitive bidding requirement."), *citing* D.P.U. 10-114, p. 221; *National Grid*, D.P.U. 10-55, p. 342; *Bay State Gas Co.*, D.P.U. 09-30, p. 227; *Fitchburg Gas & Electric Light Co.*, D.P.U. 07-71, p. 99–100; D.T.E. 03-40, p. 153. Rather than making a showing that any unusual circumstance exists as to these expenses, the Company relies on perfunctory justifications. First, as to Mr. Hevert, the Company seeks to recover his expenses based on the not-so -unusual condition that he was qualified to provide his analysis. Second, as to Mr. Simpson, the Company seeks to avoid the competitive bidding requirement without any claim to an "unusual circumstance." And lastly, the Company fails to marshal any evidence in support of its claim that the Company's prior arrangement with Aon Hewitt created a "most unusual" circumstance that made issuing an RFP inappropriate.

The Company is similarly unavailing in its opposition to the Attorney General's request to limit the Company's legal fees to those that would have been charged by the true lowest cost provider. The Company's approach is three-fold: (1) the Company quibbles with the Attorney General's (as well as its own) calculation of the RFP responders' proposed rates, even though the Company's suggested calculation leads to the same conclusion as reached by the Attorney General; (2) the Company, contrary to Department precedent, seeks to shift the burden to the Attorney General to prove that the Company's choice was not "reasonable" where the Company has not gone with the lowest cost provider; and (3) the Company decries the lack of evidence that the lowest cost provider would have adopted, if asked, comparable cost containment measures, when that lack of evidence is wholly a function of the Company's failure to refresh its bid, despite the Company being asked to do so in the Company's prior rate case.

Accordingly, for the reasons set forth in the following subsections, the Department should disallow the Company's rate case expense for (a) return on equity consulting services provided by Mr. Hevert; (b) labor and benefit analyses provided by Mr. Aon Hewitt; and (c) consulting services concerning the sale of Northern provided by Mr. Simpson. The Department should also limit the amount that the Company can recover for legal services to the amount proposed by the lowest cost provider and correct a typographical error that overstates the Company's actual rate case expenses to-date.

a) Consulting Services Regarding Return on Equity.

First, the Department should disallow the Company's expense for the return on equity consulting services provided by Mr. Hevert. The Company has fallen well short of meeting its burden to demonstrate the "most unusual of circumstances" that would adequately justify the Company's decision to forego a competitive bidding process. Bay State's only proffered basis for its request that the Department allow it to recover the expenses for Mr. Hevert's service is the Company's assertion that Mr. Hevert was well-qualified to provide the services that he provided to the Company. Co. Br., p. 105. Rather than constituting a "most unusual" circumstance, the circumstances relative to Mr. Hevert's services are the most usual of them all—that the Company believes that the consultant engaged by the Company is qualified to perform the work that he or she was engaged to perform.[14] Accordingly, adopting the Company's position here would wholly eviscerate the Department's requirement that companies issue RFPs for the retention of their outside consultants. If companies were allowed to bypass the competitive bidding process simply by engaging a well-qualified outside consultant, no company would ever be required to engage in an RFP process as to any outside consultant and costs will be higher. Therefore, the Department should reject the Department's request to recover Mr. Hevert's expenses from ratepayers.

[14] The Company's reliance on Mr. Hevert's qualifications as a basis for recovery is especially thin here, given its admission that they made no effort to seek consultants with comparable experience to Mr. Hevert. Exh. AG-25-25.

b) Consulting Services Regarding the Sale of Northern Utilities, Inc.

Second, the Department should disallow the Company's expense for the consulting services regarding the sale of Northern that were provided by Mr. Simpson because the Company did not issue an RFP, and the Company does not identify any unusual circumstances that would justify foregoing the competitive bidding process. In its Initial Brief, the Company recognizes, as it must, that "[t]he competitive bidding process must be structured and objective, and based on a RFP process that is fair, open, and transparent." Co. Br., p. 97, *citing* D.P.U. 10-114, p. 221; D.P.U. 09-30, p. 227–28; D.P.U. 07-71, p. 99–100; D.T.E. 03-40, p. 153.

Here, the Company did not issue an RFP for the services provided by Mr. Simpson. Exh. CMA/JTG-1, p. 25; Exh. DPU-2-10. Rather, the Company used an RFP as to other services that the Company sought as a tactic in its negotiations with Mr. Simpson. Co. Br., p. 102. The Company's tactic, however, is insufficient to meet the Department's requirement that the Company issue a RFP. *See* D.P.U. 10-114, at 221; D.P.U. 09-30, at 227–28; D.P.U. 07-71, at 99–100; D.T.E. 03-40, at 153. The Company's tactic did not allow for a "competitive bidding process" that was "open" to solicitations from other providers. *Id.* Rather, the Company's tactic presupposed that the Company would ultimately engage Mr. Simpson. Exh. DPU-2-10; Exh. DPU-2-12. Irrespective of whether the Company believes that it was effective when negotiating with Mr. Simpson, without a competitive bidding process, the Department lacks "an objective method to determine whether the services could have been adequately provided at lower costs." D.P.U. 10-70, p. 158, *citing* D.P.U. 09-30, p. 230 and D.T.E. 03-40, p. 151. Indeed, the record suggests that the Company potentially left significant savings on the table by negotiating exclusively with Mr. Simpson. *See* AG Br., pp. 108–10. Accordingly, because the Company has failed to meet its burden to prove that the "most unusual of circumstances" existed to justify its decision to bypass the RFP process, the Department should deny the Company's request to recover from ratepayers its expenses for Mr. Simpson's services.

c) Labor and Benefit Analyses.

Third, the Department should disallow the Company's expense for the labor and benefit analyses provided by Aon Hewitt. Here, the Company simply cannot meet their high burden to prove that the unusual circumstances justified their departure from the Department's competitive bidding requirement. The Company asserts that Aon Hewitt had an ongoing relationship with Bay State in which it conducted analyses that were related to the analysis that it conducted for the Company as part of this case. Co. Br., pp. 101–02. However, prior familiarity with relevant subject matter is insufficient to constitute a "most unusual" circumstance that would justify foregoing the competitive bidding process. *See* D.P.U. 10-70, p. 159. Nor has the Company proffered any specific evidence that proves that there is anything particularly unusual about the relationship between the Company and Aon Hewitt that made issuing an RFP impractical.[15] Without any specific evidence supporting the Company's claim that issuing an RFP for the Company's labor and benefit analyses would be impractical, the Company cannot meet

[15] Tellingly, the sole support in the Company's Initial Brief for its position that issuing an RFP would be impractical is a seven page section of the cross-examination of the Company's witnesses relative to the Company's rate case expense. Co. Br., pp. 101–02, *citing* Tr. Vol. V, at 616–22. Within the scope of the Company's citation, only approximately a dozen lines of Mr. Bryant's testimony are actually relevant to the proposition cited, and which themselves provide few specifics as to why the Company believed an RFP to be impractical. *Compare* Tr. Vol. V, pp. 616–22 with *Id.*, pp. 620–21.

their burden to prove any "most unusual of circumstances." Accordingly, the Department should reject the Company's request to recover Aon Hewitt's fees from ratepayers.

d) Legal Services.

In its Initial Brief, the Company proffers a number of arguments in support of its opposition to the Attorney General's request to limit the Company's recovery of legal costs to the rates offered by Brown Rudnick during the RFP process. All of the Company's arguments are without merit.

First, the Company contends that the hourly rates for Brown Rudnick and Keegan Werlin are not comparable because one provider proposed a blended hourly rate and the other did not. Co. Br., p. 103. The Company's contentions are belied by the documents produced in this proceeding, which demonstrate that the Company itself compared the two hourly rates and found Keegan Werlin's to be higher. Exh. DPU-2-04 (Legal) Attachment (Revised Redacted), p. 11; Exh. DPU-2-04 (Legal) (Confidential), p. 9. Although the Company now contends that a better comparison would involve "a proportional share of the work performed by differing levels of attorneys," that analysis would actually increase the disparity between Keegan Werlin's proposed rates and Brown Rudnick's. Co. Br., p. 103. In their response to the RFP, Keegan Werlin provided the Company with a "% of total hours" breakdown for each level of attorney at Keegan Werlin. Exh. DPU-2-03 (Legal) (C) (Redacted), p. 3. If the Department recalculates the rate for Keegan Werlin by creating a "blended" rate that weights each attorney by his or her proposed billing rate and his or her estimated share of total hours, Keegan Werlin's "blended" rate increases from the rate originally calculated by the Company because [redacted]

[redacted] Exh. DPU-2-03 (Legal) (C) (Confidential), p. 3. Accordingly, the Company's contention here is nothing more than a distraction—under any basis of comparison, Brown Rudnick proposed to perform the work at a lower rate than Keegan Werlin.

Second, the Company complains that there is "no analysis of the hours to perform various tasks and how the hours spent on those tasks could vary between law firms and between lawyers on the case." Co. Br., p. 104. However, there is simply no evidence in the record to suggest that lawyers at Brown Rudnick would have spent any more time than the lawyers at Keegan Werlin completing various tasks relative to this rate case. Indeed, the Company's rate case expense witnesses did not identify "efficiency" as a concern when asked to identify any specific concerns relative to the attorneys who were included in Brown Rudnick's response to the RFP. Tr. Vol. V, pp. 632–633. It is the Company that has a burden to prove—not the Attorney General's to disprove—that where the Company selects a provider other than the lowest cost provider, its choice was reasonable and cost effective. *See Western Massachusetts Electric Company,* D.P.U. 11-01, pp. 247–48.[16] The Company cannot shift its burden to prove that its choice to select a higher cost provider was "reasonable and cost effective" to the Attorney General, nor can it meet that burden with nothing more than unsupported speculation.

[16] The Company's additional argument that the Department should nonetheless decline to limit the Company's legal expenses because the Attorney General did not make a showing that the "Company's selection was not reasonable or cost-effective, other than the billable hourly rate" also misplaces the burden. Co. Br., p. 104. It is the Company that has a "heightened" burden to justify its costs when it declines to engage the lowest cost provider. *See* D.P.U. 11-01, p. 247–48. The Department need only find that Brown Rudnick was "a lower priced, experienced and qualified consultant who was well known to the Company [and] was available and capable of completing the work on time." *Id.* The record, as demonstrated by the Company's own documents and testimony, unambiguously reflects that Brown Rudnick was highly experienced and qualified and would have been a more than reasonable choice to represent the Company in this rate case. *See, e.g.,* Tr. Vol. V, pp. 632–634.

Finally, the Company contends that the Department should disregard the Attorney General's requested limitation of the Company's legal fees because "there is no basis" to conclude that Brown Rudnick would have agreed to comparable cost containment measures when asked to do so in a refreshed bid. Co. Br., p. 104. However, the lack of any such basis is precisely the point. Any absence of evidence is wholly due to the Company's failure to meet the Department's express expectation that, after its last rate case, the Company would refresh its bids, where appropriate, in the future. D.P.U. 09-30, pp. 229–30. The Company should not be rewarded for its failure to conform to the Department's instructions with a favorable inference that Brown Rudnick would have rejected cost containment measures comparable to those agreed to by Keegan Werlin.

Accordingly, the Company's arguments against limiting the recovery of its legal fees are without merit. The Department should recalculate Keegan and Werlin's legal fees based on the rate(s) offered by Brown Rudnick less any cost containment measures implemented by Keegan Werlin, consistent with the Department's calculation in *Western Massachusetts Electric Company*, D.P.U. 11-01, p. 252.

e) Actual Costs.

Finally, the Department should ensure that the Company is limited to recovering only its actual costs. In that regard, the Attorney General notes what appears to be a significant typographical error that overstates the Company's invoiced rate-case expense by approximately $40,000. Specifically, the Company's calculations include a $45,515.00 invoice from Gannett Fleming on October 18, 2011. Exh. DPU-2-8 (Supp.)(A), p. 11. However, a review of the actual invoice reveals that the amount charged for the October 18, 2011 invoice was only $4,555.22. Exh. DPU-2-8 (Line 4), pp. 23–25.

E. CAPITAL STRUCTURE AND RATE OF RETURN

1. OVERVIEW.

Bay State's Initial Brief focuses on the minutiae of the cost of capital testimony in this proceeding and ignores the major issues that affect the capital costs for the Company. Therefore, the arguments made by the Attorney General in its Initial Brief remain unrefuted, and the Department should adopt recommendations proffered by the Attorney General's witness, Dr. Woolridge.

2. CAPITAL STRUCTURE

In its Initial Brief, Bay State argues that the Department should adopt Bay State's requested capital structure consisting of 46.30% long-term debt and 53.70% common equity because the capital structure (i) does not "deviate substantially from sound utility practice" and (ii) is consistent with the capitalization rates of other comparable gas distribution companies. These arguments do not address the reasoning of the Attorney General's capital structure position. The Attorney General provides evidence that the bond ratings and debt costs of Bay State are directly tied to the capital structure of Bay State's parent, NiSource. In the words of Standard & Poor's:

> The stand-alone financial profiles of NiSource's utility subsidiaries are much stronger than the consolidated financial profile, where substantial acquisition-related debt is held. Nevertheless, we view the default risk as the same throughout the organization, due to the absence of regulatory mechanisms or other structural barriers that sufficiently restrict subsidiary cash flow to the holding company.

Exh. AG-6-3 Attach. (A), Global Ratings Portal - Ratings Direct, Standard & Poor's, NiSource Inc., February 23, 2012.

Therefore, in order to recognize that Bay State's ultimate source of capital, its bond ratings, and its debt cost rates are all from NiSource, Dr. Woolridge has averaged the long-term debt and equity capital structure ratios for Bay State and NiSource. This approach results in a capital structure consisting of 50.77% long-term debt and 49.23% common equity. Dr. Woolridge has shown that this capitalization is consistent with the capitalizations of the companies in his Gas Proxy Group.

3. INTEREST RATES AND CAPITAL COSTS

Dr. Woolridge also highlights the fact that interest rates and utility capital cost are at historically low levels. Dr. Woolridge indicates that the current rate on long-term, A-rated public utility bonds were only 3.76% as of June 1, 2012. He also indicated that interest rates have not been this low since the 1950s or since "the time of Sputnik." Tr. Vol. XI, pp. 1462-1463. Appropriately, Dr. Woolridge's ROE recommendation of 8.50% reflects these historically low interest rates and capital costs.

4. BAY STATE'S REQUESTED ROE OF 11.75% IS "PREPOSTEROUS"

Given the low interest rate and capital cost environment, Dr. Woolridge testified that the Company's requested ROE of 11.75 percent is "preposterous" and "way out of line." Tr. Vol. XI, p. 1515. Under cross-examination, Dr. Woolridge stated the case this way:

> I think the big picture is that the company is requesting 11.75. I'm at 8.5. And we're talking about two years -- I mean, three years from where the Department said, gave the company 9.95, and since that time, you know, capital costs have declined by 200 basis points or so. I think that's the big picture.

Tr., Vol. XI, p. 1514.

Mr. Woolridge demonstrated that the Company's ROE request is inexplicably high in today's low interest rate environment due to a number of errors in Mr. Rae's equity cost rate studies. These errors, which are detailed in the Attorney General's Initial Brief, include the: (i) use of the combination utility and non-utility groups to estimate an equity cost rate for Bay State; (ii) excessive reliance on the EPS growth rate forecasts of Wall Street analysts and *Value Line* as a DCF growth rate; (iii) asymmetric classification and elimination of DCF results; (iv) base interest rate in the CAPM and risk premium approaches; (v) measurement and magnitude of the equity risk premium used in CAPM and risk premium approaches; (vi) validity of the comparable earnings equity cost rate approach; and (vii) the adjustments for size and flotation costs.

5. THE COMPANY'S FAILURE TO REFINANCE ITS LONG-TERM DEBT WILL COST CUSTOMERS MORE THAN $5 MILLION A YEAR

Bay State's failure to refinance certain issues of its outstanding long-term debt is costing the Company (and its customers) more than $5.1 million a year in interest expense. Exh. AG/TN-1, Att. A. As a result, the Attorney General demonstrated an implied cost rate of long-term debt between 3.67 percent and 4.67 percent would be a reasonable cost of debt for the Company and recommended the high end to establish base rates in this case. AG Br., pp. 162-164. The Company argues in reply that (i) the Department rejected this request in its last finance case in D.P.U. 11-41 and therefore a similar decision is appropriate in this case; (ii) the current indications are that the cost of long-term debt is between 5.00 and 5.25, percent not 4.67 percent; (iii) any attempt on the Company's part to refinance its debt with its affiliate, NiSource Finance Corp. would "destroy" Bay State's intercompany financing arrangements with that affiliate, implying that it would force NiSource Finance Corp to refinance all of its outstanding notes with its affiliates; and (iv) it would require Bay State to immediately refinance $170 million in debt at prohibitively high interest rates. Co. Br., pp. 139-141. All of these assertions do not withstand scrutiny.

The Department's decision in the Company's financing case in D.P.U. 11-41 not to order the refinancing of its outstanding debt with NiSource Finance Corp. with the proceeds from the issuance in that case does not mean that the Department cannot and should not recognize the imprudence of the Company's failure to refinance in this case.[17] In D.P.U. 11-41, the Company was using the proceeds from the case to finance existing constructions and to refinance some existing debt that was coming due. D.P.U. 11-41, p. 22. The Department chose not to interfere with those activities by diverting the proceeds to refinance other outstanding debt. *Id*. Its findings in that docket, however, to not proscribe it from recognizing that the Company could have and should have filed another petition to refinance the other outstanding debt with NiSource Finance Corp. Moreover, in that case, the Department stated back in the fall of 2011 that it wasn't convinced that interest rates were low enough to refinance these outstanding notes. *Id*. Interest rates have been and continue to be the lowest that they have been in more than fifty years. Tr. Vol. XI, pp. 1462-1463. A savings of more than $5.1 million per year is significant in the determination of the Company's cost of service and should not be ignored.

The Company also argues that the real cost to refinance would be 5.00 to 5.25 percent, rather than 4.67 percent that the Attorney General recommends. This claim is also not supported by the record. First, the rate that the Company cites is from the

[17] Financings are distinct in time and purpose from base rate proceedings. In a financing the standard is what is in the public interest, while in a rate case the standard is whether the resulting rates are just and reasonable. A proceeding pursuant to G.L. c. 164, § 14 cannot abrogate the requirement that the Department set just and reasonable rates in a section § 94 proceeding.

Merchant publication that is reporting interest rates from May of 2012. More recent interest rates are as much as 50 basis points lower. Exh. AG-JRW-3, p. 1. Second, those rates are only for 30-year bonds. If the Company refinanced the notes with anything less than 30-year debt, the interest rate would be substantially lower. *See* Exh. AG/TN-1, Att. A.

The Company's argument that refinancing these notes with NiSource Finance Corp. will somehow upset the special relationship between the two affiliates is meaningless. First, the "special" relationship goes no further than the debt agreements that exist between the two corporations. *See* Exh. AG-11-13. Second, Bay State Gas is under an obligation to minimize costs, and if there is a legal provision in those debt agreements that would lower the Company's costs, it is required to do so, as would any business in a competitive market. Third, the Company's claim that NiSource Finance Corp. would have to recall and make whole on all of its outstanding debt if Bay State refinances it debt is simply a red herring. There is no requirement in this or other debt instruments that all debt would have to be recalled, if one is recalled. Fourth, there is no proof that NiSource Finance Corp. in fact issued debt, much less non-callable debt directly tied to the notes that it has outstanding with Bay State. Indeed, since all of these dollars become fungible at the holding company level, it is possible that the Bay State notes were financed with short-term debt and the parent corporation is actually benefiting by millions of dollars by leveraging the long-term interest rate it charge customers with short-term rates that it could actually be financing them with. Finally, to the extent that the NiSource Finance did in fact issue exactly the same notes to the market, and did not provide call provisions in them, or provide some other hedge against the possibility that those notes might be called by Bay State, that is not the customers fault and that imprudence and the associated costs should not be their burden.

Finally, Bay State attempts to make a claim that it will not be able to issue debt at reasonable rates, if it has to "go it alone" without NiSource Finance Corp. It is understandable that the Company's management may not remember when the Company was on its own, in the days before NiSource acquired it. At that time, even though Bay State was a smaller company, it seemed to do quite well financially, boasting a higher A bond rating, with lower rates, and lower financing costs. There is no reason that the Company could not do that today, except for the constraints put upon it as a result of the NiSource acquisition.

For all of the above reasons, the Department should reduce the cost of debt that it uses to set base rates in this case to reflect the refinancing of the Company's outstanding debt with NiSource Finance Corp. and use a 4.67 percent interest rate for long-term debt in calculating the overall return on rate base.

6. THE ATTORNEY GENERAL'S ROE RECOMMENDATION

The Company makes three arguments objecting to the Attorney General's proposed return on equity ("ROE") recommendation of 7.40 percent. Specifically the Company states that: (i) the Attorney General's recommended ROE "is insufficient to allow the Companies to maintain its credit and ability to attract capital;" (ii) the recommendation is "outside the record evidence;" and (iii) "[t]o make this recommendation, the Attorney General has to reject her own witness' recommendation of 8.50 percent." Co. Br., pp. 57-59. Once again, none of these arguments is supported by the record or Department precedent.

The Department uses the *Bluefield Waterworks and Improvement Co. v. Public Commission*, 262 U.S. 679, 692-695 (1923) and *Federal Power Commission v. Hope Natural Gas Company,* 320 U.S. 391 (1942) standards to provide some of the parameters that it uses to determine the cost of common equity for a utility. Bay State maintains that the Attorney General's recommendation does not comport with these standards. The Company claims that the "guiding principle" in setting a return on equity is that it must be "commensurate with returns on investments in other enterprises having corresponding risks." Co. Br., p. 157. However, in making its argument, the Company omits a crucial legal requirement in setting a return on equity. In the *Bluefield* decision, the Court found that a fair rate of return for a regulated utility:

> should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under **efficient and economical management**, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

Bluefield Waterworks & Improvement Company v. Public Service Commission of West Virginia, 262 U.S. at 693. (Emphasis added).

As set forth in the Attorney General's Initial Brief, Bay State is not efficiently and economically operated. AG Br., pp. 185-186. Questionable management performance requires that the return on equity should be set at the low end of the range of reasonableness. *Cambridge Electric Light Company,* D.P.U. 92-250, p. 161-162 (1993). The Department has rejected the argument that a Company's return on equity must be set at the same level of other utilities. *Massachusetts Electric Company,* D.P.U. 92-78, p. 115 (1992). The Department "must consider the evidence presented in each case. . . ." *Massachusetts Electric Company,* D.P.U. 89-194/195, p. 199 (1990); *Western*

Massachusetts Electric Company, D.P.U. 88-123-B, p. 58 (1991). The Company "is under a continuing obligation to amend seasonably its responses to discovery, direct examination, and cross-examination if it later obtains information that the response was incorrect or incomplete, or if the response, though correct when made, is no longer true or complete." *Fitchburg Gas & Electric Light Company*, D.T.E. 02-24/25, p. 32 (2002) citing 220 C.M.R. § 1.06(6) (c) (5). Something Bay State failed to do with respect to (i) its decision not to pay salary increases to its non-union employees that it testified to and (ii) its failure to disclose receipt of tax refunds during the pendency of the D.P.U. 09-30 rate case. The failure to provide the Department with complete information regarding a number of issues requires that the return on equity should be set at the low end of the range of reasonableness. *See* D.T.E. 02-24/25, p. 231.

The Attorney General's recommendation is based on the record evidence. Dr. Woolridge has estimated an equity cost rate for Bay State to be in the range of 7.40 to 8.50 percent by applying the DCF and CAPM approaches to his Gas Proxy Group. The Attorney General's recommendation is consistent with the low end of Dr. Woolridge's calculations. While the Company claims that a "ROE of 7.40 percent is not reasonable by any objective measure," (Co.Br., p. 157), a simple arithmetic calculation proves that this is not an accurate observation. As Dr. Woolridge testified, in the big picture, interest rates on utility bonds have declined by about 200 basis points[18] since the Company's last rate case. Without even weighing the various factors in setting an ROE, the 9.95 percent ROE awarded in D.P.U. 09-30 is the equivalent to a 7.95 percent ROE today, without any adjustment for the Company's lack of candor.

[18] Exh. AG/JRW-1, p. 2.

Finally, the Company argues that the Attorney General has rejected her own witness' recommendation of 8.50 percent. This is not correct. Dr. Woolridge calculated a ROE for an efficient and economically managed utility. However, the evidence discovered during the hearing process, establishes a "subpar management performance in terms of regulatory support." D.T.E. 02-24/25, p. 231. Department precedent requires that in these instances, the return on equity should be set at the low end of the range of reasonableness, notwithstanding Dr. Woolridge's recommendations.

F. DEPRECIATION

The Attorney General's depreciation witness, Mr. Michael J. Majoros, Jr., demonstrated that both Bay State's current depreciation rates and its new proposed depreciation rates are excessive. Exh. AG/MJM-1. Mr. Majoros prepared an independent depreciation study proposing new, straight-line whole-life depreciation rates combined with a separate net salvage allowance. Exh. AG/MJM-3. When applied to June 30, 2011 plant balances, these recommendations produce an annual depreciation expense of $26,110,726. Mr. Majoros also recommended a $5,283,554 negative amortization of Bay State's regulatory liability for cost of removal. Exh. AG/MJM-10-B. The net depreciation and amortization expense resulting from Mr. Majoros's recommendations is, based on the June 30, 2011 balances, $19,255,742, instead of Mr. Spanos' $40,082,816 proposal, which Mr. Gore subsequently increased. Exh. AG/MJM-10-A. The reasons for Mr. Majoros reductions to depreciation expense are:

- Bay State's current depreciation accruals are and have been excessive.
- Mr. Spanos' proposals result in a continuation of excessive depreciation accruals.
- Bay State is collecting and will continue to collect excess cash flow if Mr. Spanos' proposals are accepted.

Exh. AG/MJM-1, p. 20.

1. WHOLE-LIFE DEPRECIATION

The Attorney General recommends that the Department order Bay State to adopt the whole-life method for depreciating the Company's plant assets. Mr. Majoros demonstrated that the whole-life method is an improvement not only for the imbedded plant investment, but also for the future plant additions flowing through a capital tracker like the TIRF. Exh. AG/MJM-1, pp. 6-11 and 46-48. Bay State argues that the Department must reject the whole-life technique proposal because the remaining life technique is simpler. Co. Br., p. 169. This is not true.

In truth, it is much simpler to calculate a whole-life rate, which is merely the reciprocal of the life, than a remaining life rate, which requires massive remaining life calculations reflecting numerous dispersion patterns and the estimate of accumulated depreciation as of the study date. *Id*. Bay State's "simplicity" assertion is unsupported and should be rejected by the Department. Furthermore, Bay State asserts that "the remaining life technique has a self-adjusting mechanism, which recovers the accumulated depreciation deficit or surplus over the remaining life." Co. Br., p. 169. However, the remaining life technique necessitates regular periodic deprecation studies, regardless of any "self-adjusting mechanism," for the Commission to continually monitor the propriety of current depreciation rates. In fact, the Company's witness has recommended these recurring analyses in previous depreciation studies. *See e.g.* Exh. AG-10-44, Att. A, p. 8 ("it is further recommended that detailed depreciation service life studies continue to be completed on a regularly scheduled basis"). These issues can be more easily dealt with if whole-life, rather than remaining life deprecation rates, are used. Therefore, the

Department should use the whole-life method to determine the depreciation accrual rates for Bay State.

2. LIFE SPAN DEPRECIATION TREATMENT

The Attorney General recommends that the Department reject the Company's proposed life span treatment for Account 305 (MGP Structures and Improvements) and Account 375.7 (Structure-Other Distribution Systems) because an economic study was not performed and retirement plans have not been developed for these assets. AG Br., pp. 143-144. The Company argues that the Attorney General's recommendation should be rejected because the life span treatment is most appropriate approach for the assets in these accounts. Co. Br., pp. 172-173. While Bay State believes the life span treatment is the most appropriate approach for these accounts, it also acknowledges that because it has not provided a basis upon which to judge the reasonableness of the life spans it proposes, its proposals are not based on the requirements for the use of the life span approach as articulated in the NARUC Depreciation Practices Manual. *Id.* The Company does not have any plans or studies to support the estimates; thus, its proposals reflect an exercise in specious precision. Therefore, the Department should reject the Company's life span treatment for plant Accounts 305 and 375.7.

3. PROPOSED SURVIVOR CURVES

The Attorney General recommends the Department order the Company to use survivor curves that are than the ones it has proposed for Account 375.2 (Measuring and Regulatory Equipment Structures), Account 376.2 (Mains Coated/Wrapped), Account

376.7 (Mains Other Valves), Account 376.8 (Cast Iron), and Account 380 (Services).[19] AG Br., pp. 144-147. The Company argues that the Department should reject the Attorney General's recommendation because they are based on the Attorney General's witness utilization of Geometric Means Turnover ("GMT") method to develop his recommended survivor curves. Co. Br., pp. 174-178. This assertion is false.

Mr. Majoros clearly stated and demonstrated that his life estimation analysis was much more extensive and multifarious then his use of the GMT method. As Majoros indicated:

> Mr. Spanos used two basic life study methods: the life span method and the retirement-rate actuarial method. **In addition to these methods, I also used a third method: the Geometric Mean Turnover method**.

Exh. AG/MJM-1, p. 22. (Emphasis added). Mr. Majoros' study and testimony is quite clear. He used the life span and the retirement rate actuarial methods to determine his life span estimates and supplemented those methods with the GMT method. The GMT method was not the only method that he used and the Company's complaints to the contrary should be rejected by the Department.

4. NET SALVAGE PROPOSAL

It is the Attorney General's position that the Company has been grossly overcharging customers for its cost of removal. The Company is proposing to collect $11.8 million each year for a cost that is only $1.3 million each year on average. AG Br., pp. 147-154. Furthermore, the record shows that (i) Bay State does not have a legal

[19] In its brief, the Attorney General erroneously indicated that she was recommending a shorter survivor curve for Account 376.3 (Mains Bare Steel). Compare Attorney General Brief, p. 143, with Tr. Vol. XII, p. 1536.

obligation to incur a majority of these future costs (and therefore they should not be capitalized, i.e. included in depreciation rates); (ii) the Company's net salvage ratios are overstated because it uses a method to estimate these costs which front-loads future inflation expenses to current consumers; (iii) the net salvage studies suffer from a mismatch in the value of dollars between the installation and removal dates of their retired assets; (iv) the mismatch has and does lead to exorbitant current charges to current ratepayers for inflated future cost estimates; and (v) the Company's approach flies in the face of the "intergenerational equity" concept because it front-loads future inflation costs into current periods, and extracts excess payments from current ratepayers, thereby overcharging ratepayers in the early years and undercharging them later. *Id*. The Attorney General also demonstrated that the Company's approach is also inconsistent with accrual accounting because (i) it collects a fictitious future cost because Bay State does not have any obligation to incur the future costs; (ii) its approach does not properly match inflation expense to the periods incurred; (iii) the depreciation rate, which is more than necessary to depreciate the plant, produces an anomalous outcome in which the depreciation reserve actually exceeds the gross plant balance; (iv) it fails the fundamental matching tests that are specifically precluded by GAAP; and (v) nothing in the USoA requires depreciation rates based on inflated future costs. Ultimately, the Company's approach is not accrual accounting and results in an intergenerational inequity that is manifested in a $142.6 million regulatory liability. *Id.* To correct this inequity, the Attorney General recommends that the Department reject the Company's approach in its entirety and, in the alternative, recognize only the actual cost of removal expense which should be normalized over five years and added to Bay State's depreciation expense. *Id*.

Bay State asserts that the Attorney General's recommendation that the Department prohibit Bay State from collecting its future net salvage costs in current depreciation rates is a "radical departure from nationally accepted regulatory policy and Department precedent, which will fail to achieve intergenerational equity for all customers." Co. Br., pp. 178. According to the Company, current GAAP accounting has highlighted the problem with "the current policy of the Department, the overwhelming majority of state utility commissions, and the FERC." *Id*. Specifically, GAAP requires Bay State to identify and report the excess collections as a regulatory liability. These collections resulted from an intergenerational inequity. Bay State has collected $142.6 million from its ratepayers to replace and retire its plant, but it has not spent the money for that purpose and until it does, it owes that money to its ratepayers. The Department should change the policy that allowed Bay State to collect the excessive amounts to begin with and protect the $142.6 million until it is returned to ratepayers.

5. REGULATORY LIABILITY AND AMORTIZATION

The record repeatedly shows that Bay State's ratepayers have paid the Company $142.6 million more than the its actual cost of removal and cost of removal requirements. AG Br., pp. 147-154 (citing Exh. AG/MJM-1, pp. 34-44). The Attorney General recommends that the Department officially recognize this regulatory liability, just as GAAP and the SEC have recognized it, and amortize the amount over a 27-year period. Bay State asserts that this proposal is flawed because it is based on the Attorney General's opposition to the recovery of net salvage costs and the remaining life technique. Again, Bay State is mistaken. The Attorney General's proposal recognizes the obvious—Bay State reports in its official financial statements a $142.6 million regulatory liability as a result of collecting excess cost of removal charges from prior customers. These dollars should be returned to customers, where they belong.

G. RATE STRUCTURE

1. PRODUCTION AND STORAGE ALLOCATION

Despite the Company's countervailing arguments, the Attorney General stands by its position as articulated in its initial brief regarding the inclusion of baseload volumes as part of the design day allocator. With respect to the Attorney General's position that Production and Storage ("P&S) costs should also be allocated to transportation customers, the Company is silent in its brief. We can only conclude that the Company has no argument with this allocation, and therefore transportation customer volumes must be added to the Company's P&S Allocators in order to properly allocate P&S costs. Transportation customers use these facilities and pay for them through their marketer which then flows thru the CGA. The COSS should reflect the allocation of these costs to the appropriate rate classes, and not disproportionately allocate them to classes with a higher percentage of sales customers, most notably residential classes which have no transportation customers. To continue to do so violates the longstanding prohibition against inappropriate cost shifting. *Boston Gas Company*, DPU 96-50 (Phase I), pp. 133-134 (1996); *Boston Gas Company*, D.P.U. 93-60, pp. 331-337, 410, 432 (1993).

2. ELECTRONIC BILLING

The Company argues that assigning the cost savings of electronic billing to the customers who use it is arbitrary and selective. Co. Br., p. 194. Separating out a known and measureable adjustment for cost allocation is appropriate in the same way that the Company' separate treatment of the various activities in Account 903 is appropriate. The

Company goes to the trouble of making cost of service adjustments much smaller than the $88,000 adjustment proposed by the Attorney General. The rate allocation proposed by the Attorney General deserves a reasonable amount of detailed examination as well. Allocating cost savings of $88,000 is a significant enough amount to justify separate attention.

The Company mistakenly assumes that the Attorney General advocates that all Account 903 expenses should be allocated on the proposed 903 allocator. That is not the case. The Attorney General's intent was to allocate only the line item of Customer Billing and Payment Expense Processing (Line 29 of Schedule MPB 1-3, page 9 of 23 totaling $1.1 million) by this allocator. Alternatively, Postage Expense (Lines 33 and 34 off Schedule MPB 1-3, page 9 of 23 totaling $1.5 million and $34,500 respectively) should be allocated by the number of paper bills instead of by the number of customers As electronic billing expands, this allocation will become more significant. The predominant cost of a paper bill is postage as confirmed by the Company's witness Mr. Balmert. Tr. Vol. XIII, pp. 1657-1658. As electronic billing grows[20], the costs of paper billing should remain with the classes of customers still receiving paper bills. At a minimum, postage expenses should be allocated by the number of paper bills.

3. BAY STATE HAS UNDERSTATED ITS BILLING DETERMINANTS

The Company takes issue with the Attorney General's suggestion that the Company look at significant weather impacts on use per degree days in future rate proceedings. The Company argues that its weather normalization methodology has been routinely employed and approved by the Department in past rate proceedings. Co. Br., p.

[20] The Company states that electronic billing is optional and customers may switch back. There is no evidence that customers migrate back to paper billing once they have switched to electronic billing.

198. While the Company's methodology has not changed, the weather has. The calendar months of November and December of the 2011 test year had some of the warmest weather seen in the last 20 years. November, in all three of Bay State's Divisions, was at least 18 percent warmer than normal. December ranged from 13 to 18 percent warmer than normal. Exh. AG-6, Exh. JAF 1-6-B and C. On a billing basis, the differences reside in October and December and range from 20 to 31 percent colder than normal. Bay State ignores the fact that usage levels per degree days vary by month because as temperature levels vary, usage per degree day varies. Customers don't just start using more gas because it is November. There is an underlying reason. Usage per degree day varies by temperature and in a significantly warmer or colder than normal month usage per degree day can vary significantly from normal. Bay State's witness Ferro agreed that this could be the case. Tr. Vol. IV., p.438. The implications are that billing determinants could be understated in the case of significantly warmer than normal weather or overstated for significantly colder than normal weather and if the test year is not adjusted. This could cause the Company to over-collect their revenue requirement if understated or under-collect if billing determinants are overstated. The Attorney General posits that it would be reasonable to undertake an analysis to examine the difference in use per degree day at different levels of temperatures if such abnormal weather occurs in the winter periods in a future rate proceeding.

The Company summarily rejected the Attorney General's suggestion as arbitrary, unnecessary and unproven. Co. Br., p. 199. Such an objection to reviewing this phenomenon, which the Company's witness agrees occurs, shows the Company has a distinct lack of interest in improving its weather normalization methodology. Analysis should evolve as more information becomes available and conditions change. Bay State seems to be uninterested in improving the accuracy and reliability of a key component of rate design. This is not acceptable for a utility of its size in this state. The Department should order Bay State to undertake further analysis of use per degree day within months in the event of significantly warmer or colder temperatures for future rate proceedings.

H. THE COMPANY'S MARKETING PLANS

1. BAY STATE IS NOT PERFORMING LIKE OTHER MASSACHUSETTS GAS UTILITIES.

Bay State's criticism of that the Attorney General's witness' growth analysis in Exhibit AG-7 and her concern regarding the Company's marketing practices misses the point.[21] The Attorney General is looking not only at the data provided by its witness, but also the following factors, viz., (i) the frequency of rate cases filed by Bay State compared with other LDCs; (ii) the assertion that conversions for Bay State's non-heating customers and along-the-main-customers are "tapped out;" and (iii) the reality that Bay State's witness did not provide any compelling approaches that the Company is taking to grow and offer cleaner and more economical natural gas to non-gas consumers in its service territory. The Attorney General is concerned about the source of future growth to defer Bay State's next base rate case and also how non-gas customers will be able to access natural gas that will yield cleaner air through decreased building emissions.

There is currently a large spread between natural gas and fuel oil prices. This is presenting an opportunity to help consumers lower their heating costs and help clean up

[21] Ms. Bachelder's analysis used the only reliable aggregated LDC specific public data available to compare company to company for the same time periods. Each company self-reports to Energy Information Agency ("EIA") and data is not yet available for 2011. Looking at more than 10 years ago is irrelevant. Looking at the last 5 and 10 years of consistent data is completely relevant to try and get a big picture snap shot of peer performance. Clearly the most recent data – the last 5 years - is the most relevant.

the environment. A recent article in the Boston Globe[22] cites several examples of how consumers can cut their heating bills by up to 67 percent if they invest in a conversion to natural gas:

> Though this past winter was mild, **oil customers still paid much more to heat their homes - $2,238 on average - than did natural gas consumers, who shelled out $868 on average,** according to the US Energy Information Administration.
> . . . the Needham homeowner preparing to convert to natural gas, estimated his **heating bills will be less than half the $4,000 or so he spent for oil.**
> The strain of running its 100-year-old oil-heat system finally persuaded the Panagia Greek Orthodox Church in Cohasset to convert to natural gas. The congregation held a fund-raiser and sold its antique steam radiators to come up with the $40,000 to pay Wood to convert the system. Wood estimates **the church's heating bill, typically $10,000 to $12,000, will be cut in half.**
> **Emphasis added.**

Bay State gives excuses as to why they cannot grow, not solutions. The Company claims that its along-the-mains market is saturated and that it is "tapped out," but offers evidence that it is making all reasonable efforts to expand its customer base. Another excerpt from the aforementioned Globe article may provide some guidance for Bay State:

> there are still many households in Massachusetts that cannot get natural gas because their neighborhoods do not have main supply pipes. Typically utilities will install a gas main to a neighborhood if the residents are willing to pay for it. **Because of the growing popularity, utilities have taken to installing gas lines whenever a municipality is digging up its streets for other work.** Emphasis added
> In the Needham neighborhood, NStar is footing the installation bill as many residents have indicated they will sign up for service.

[22] Notte, Jason, Demand grows in N.E. for natural gas heat, April 25, 2012. http://www.boston.com/business/articles/2012/04/25/demand_grows_in_ne_for_natural_gas_heat/

> NStar is running a new gas line to his neighborhood after nearly two-thirds of the households told the utility they would consider converting.

Bay State should work with the cities and towns in its service territories and add pipe when streets are being repaved to avoid the high paving costs that Bay State's witness Mr. Bryant bemoaned (Tr. Vol. I, pp. 29-30), and be more proactive with their marketing and not be content to file rate case after rate case to maintain earnings.

Bay State complains that the income levels of their service territory are low, and the service territory is filled with renters. Co. Br., pp. 259-260. That may be true for Springfield, Brockton and Lawrence where the infrastructure may be the most built out, but Bay State has 62 other cities and towns in its service territory and many of them have good income levels—Andover, Duxbury, Norwell and North Hampton to name a few. NSTAR and National Grid also have their lower income areas, but have added large amounts of new customers; on this particular issue, the same Globe article adds:

> At NStar, conversions have tripled over the past three years; National Grid said conversions are up 34 percent in the same period.

Further, the article mentions the high efficiency boiler rebate to assist with the cost of a new conversion also mentioned by Bay State in hearings, and cites the average cost of a new conversion to be $10,000.

> Utilities have incentives to ease the cost. GasNetworks, a collective of New England natural gas companies, offers rebates from $400 to $1,500 for high-efficiency boilers, furnaces, and other equipment. Zero-interest loans are also available.
>
> The cost of converting can vary widely, from a few thousand dollars to update a younger system, to more than $10,000 for a complete kit of burner, boiler, hot water tank, and chimney liner.

Bay State is facing the same up-front cost obstacles and has access to the same mitigation methods as other Massachusetts LDCs. Bay State should do better.

2. CONTRIBUTION IN AID OF CONSTRUCTION ANALYSIS

Bay State's Contribution In Aid of Construction Analysis ("CIAC") is unnecessarily narrow. The Company refers to Department policy which states that "a gas utility is not required to serve customers in circumstances where the addition of new customers would raise the cost of gas to existing customers." Co. Br, p. 261. Turning that policy around, if a new customer's revenues contribute toward lowering the average cost of gas to all customers, all of those impacts should be considered in an analysis of the net benefits of adding new customers in concert with the determination of the appropriate CIAC amount. Bay State agrees that LDAC and Production and Storage revenues provided by new customers help to defray the costs of gas service to existing customers and the Company is open to alternative analyses to assist it in attracting new customers. Co. Br., pp. 262-263. The Department should support all new growth in an LDC's service territory that provides a net benefit to existing customers and indicate to all Massachusetts LDCs that LDAC and Production and Storage revenue contributions from new customers towards fixed costs is a valid benefit to include in analyzing the benefits to existing customers of adding new customer load.

IV. CONCLUSION

For the reasons set forth, the Attorney General requests that the Department adopt her recommendations as fully set forth in her Briefs.

Respectfully submitted,

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Dated: September 11, 2012

ATTACHMENTS

ATTACHMENT 1

BAY STATE GAS COMPANY
D.P.U. 12-25
SURPLUS REVENUE CALCULATION
FOR THE TEST YEAR ENDED DECEMBER 31, 2011

Cost Of Service	**Pro Forma (1) Amount**
Cost of Gas	$220,709,101
Operations and Maintenance Expenses	129,633,828
Depreciation Expense	18,839,361
Amortization Expense	965,169
Taxes Other Than Income Taxes	16,818,172
Interest On Customer Deposits	16,432
Income Taxes	11,240,225
Return on Rate Base	27,673,915
TOTAL COST OF SERVICE	$425,896,203
TEST YEAR REVENUES	$459,931,208
REVENUE ADJUSTMENTS (2)	($6,047,915)
TOTAL REVENUES	$453,883,293
SURPLUS REVENUE	**$27,987,090**

(1) Attachment 2
(2) Attachment 3

ATTACHMENT 2

BAY STATE GAS COMPANY
D.P.U. 12-25
SUMMARY COST OF SERVICE
FOR THE TEST YEAR ENDED DECEMBER 31, 2011

Cost Of Service	Test Year Amount (1)	Adjustments	Pro Forma Amount
Cost of Gas (1)	$221,433,715	($724,614)	$220,709,101
Operations and Maintenance Expenses (2)	139,305,356	(9,671,528)	129,633,828
Depreciation Expense (3)	36,474,724	(17,635,363)	18,839,361
Amortization Expense (4)	12,018,345	(11,053,175)	965,169
Taxes Other Than Income Taxes (5)	15,740,040	1,078,132	16,818,172
Interest On Customer Deposits (1)	-	16,432	16,432
Income Taxes (6)	7,725,687	3,514,538	11,240,225
Return on Rate Base (7)	27,233,342	440,573	27,673,915
TOTAL COST OF SERVICE	**$459,931,208**	**($34,035,006)**	**$425,896,203**

(1) Exhibit RR-AG-46, Schedule JTG-1
(2) Attachment 4
(3) Attachment 5
(4)
(5) Attachment 6
(6) Attachment 9
(7) Attachment 9

ATTACHMENT 3

BAY STATE GAS COMPANY
D.P.U. 12-25
REVENUE ADJUSTMENTS
FOR THE TEST YEAR ENDED DECEMBER 31, 2011

Revenues	Per Books	Adjustments	Annualized Revenue at Current Rates (1)
Residential Sales Revenue	$304,071,425	$4,797,283	$308,868,708
Comm/Industrial Sales Revenue	98,143,334	(3,863,641)	94,279,693
Interruptible Sales Revenue	-	-	-
TOTAL TARIFF REVENUES	402,214,759	933,642	403,148,401
Residential Transportation of Gas	257,774	(11,059)	246,715
Comm/Industrial Transportation of Gas	45,304,744	(2,633,501)	42,671,243
Off System Sales	2,354,261	(2,354,261)	-
Gas Property Revenue	553,523	-	553,523
Rental Revenue	5,690,616	-	5,690,616
Guardian Care/Inspections	10,014,414	0	10,014,414
Lost Net Rev	(83,195)	83,195	-
Residential Discount Factor	(7,059,620)	7,059,620	-
Late Payment Charges	442,631	-	442,631
Return Check Charge	33,672	-	33,672
Carrying Costs	2,713,391	(2,713,391)	-
Prod & Storage Revenues	(614,582)	10,305,623	9,691,041
TIRF Revenue	159,383	(159,383)	-
Sale of Asset Passback	204,098	-	204,098
Customer R&C Shut-off Turn-off	406,960	-	406,960
Decoupling	(2,691,508)	2,691,508	-
Resid./Comm. Energy Conserv. Serv. Program	29,888	(29,888)	-
TOTAL OTHER OPER. REVENUES	57,716,449	12,238,464	69,954,913
			-
Elimination of Indirect GAF	-	(9,288,956)	(9,288,956)
Elimination of DAF	-	(12,936,665)	(12,936,665)
Elimination of RDAF	-	2,573,998	2,573,998
Total GAF & DAF	-	(19,651,623)	(19,651,623)
TOTAL REVENUE	459,931,208	(6,479,517)	453,451,691
Increase in Special Contract Revenue (2)	$0	34,849	34,849
EP&S Rate Increases (3)		396,753	396,753
TOTAL REVENUE ADJUSTED	**$459,931,208**	**($6,047,915)**	**$453,883,293**

(1) Exhibit RR-AG-46, Schedule JTG-4
(2) Attorney General's Brief, pages 62-63
(3) Attorney General's Brief, pages 64-67

ATTACHMENT 4

BAY STATE GAS COMPANY
D.P.U. 12-25
OPERATIONS & MAINTENANCE EXPENSE ADJUSTMENTS
FOR THE TEST YEAR ENDED DECEMBER 31, 2011

Expense	Adjustment Amount (1)
Payroll Adjustment - Union	$967,554
Payroll Adjustment - Non-Union (2)	(219,620)
Incentive Compensation	(474,893)
Medical and Dental Insurance	111,779
Property & Liability Insurance Expense	147,842
Self Insurance Claims	123,753
Rate Case Expense (3)	(124,020)
Bad Debt Expense - Gas Revenue (4)	(319,644)
Bad Debt Expense - EP&S (5)	(8,240)
NiSource Corporate Services Company (2) & (6)	(6,045,599)
Charitable Contributions	(178,514)
Amortization of Deferred Farm Discount Credits	42,212
Postage	47,859
CGA & LDAC Recoverable Costs	531,980
Indirect Promotional Advertising	(4,528)
Automatic Meter Reading Lease Expense	(2,528,602)
Westborough Building Savings	(1,177,723)
NiFit O&M Charges	(35,726)
PUC Assessments	142,206
Inflation	1,296,630
Call Center Temporary Employee Expense	(172,863)
Net Effect Of Northern Utilities Sale On Operations & Maintenance Expense (7)	(1,679,000)
Executive Jets (8)	(114,371)
OPERATIONS & MAINTENANCE EXPENSE ADJUSTMENTS	**($9,671,528)**

(1) Exhibit RR-AG-46, Schedule JTG-6, page 1
(2) Attorney General's Brief, pages 95-98.
(3) Attorney General's Brief, pages 103-112 and Exhibit AG/DJE, Schedule DJE-1
(4) Includes Effects Of The Proposed Revenue Deficiency On Pro Forma Bad Debt
(5) Exhibit AG/DJE, Schedule DJE-2
(6) Attorney General's Brief, pages 87-90.
(7) Exhibit AG/DJE, Schedule DJE-5
(8) Attorney General's Brief, pages 121-122

BAY STATE GAS COMPANY
D.P.U. 12-25
DEPRECIATION EXPENSE ADJUSTMENT
FOR THE TEST YEAR ENDED DECEMBER 31, 2011

Plant in Service	Plant Account Number	Account 101 Utility Plant Balance	Account 106 Utility Plant Balance	Total Utility Plant(1)	Accrual Rate(2)	Depreciation Expense
PRODUCTION PLANT						
Structures and Improvements	305	$3,054,661	$0	$3,054,661	1.33	$40,627
Liquefied Petroleum Gas Equipment	311	4,555,943	-	4,555,943	2.22	101,142
LNG Equipment	321	8,305,489	-	8,305,489	3.70	307,303
LNG Tanks	364.31	16,938,910	-	16,938,910	1.82	308,288
TRANSMISSION AND DISTRIBUTION PLANT						
Structures and Improvements	375.2	2,269,427	-	2,269,427	1.33	30,183
Mains: Coated Steel	376.2	167,728,264	956,139	168,684,403	1.52	2,564,003
Bare Steel	376.3	1,739,110	-	1,739,110	1.39	24,174
Plastic	376.4	243,138,902	7,006,460	250,145,362	1.67	4,177,428
Joint Seal	376.5	24,483,431	347,516	24,830,947	4.17	1,035,450
Cathodic Protection	376.6	11,606,021	182,294	11,788,315	5.00	589,416
Other Valves	376.7	182,426	-	182,426	1.33	2,426
Cast Iron	376.8	5,156,019	6,997	5,163,015	0.98	50,598
Measuring & Regulating Station Equipment	378	21,611,896	-	21,611,896	2.38	514,363
Services	380	323,060,428	6,310,785	329,371,212	1.69	5,566,373
Meters	381	31,264,516	-	31,264,516	3.45	1,078,626
Meter Installations	382	68,504,410	-	68,504,410	1.82	1,246,780
House Regulators	383	11,832,095	-	11,832,095	3.23	382,177
Other Property on Customer's Premise:						
Conversion Burners	386.1	8,280,548	-	8,280,548	4.17	345,299
Water Heaters	386.2	29,735,763	-	29,735,763	7.14	2,123,133
GENERAL PLANT						
Land	389.1	172,321	-	172,321		-
Structures and Improvements	375.7	9,189,379	-	9,189,379	1.33	122,219
Office Furniture Equipment	391.1	2,527,521	-	2,527,521	5.00	126,376
Office Furniture Equipment - Data Handling	391.11	181,144	-	181,144	6.67	12,082
Office Furniture Equipment - Information System	391.12	2,736,918	-	2,736,918	20.00	547,384
Transportation Equipment - Trailers	392.2	36,454	-	36,454	10.00	3,645
Stores Equipment	393	46,405	-	46,405	4.00	1,856
Garage and Service Equipment	394.1	332,280	-	332,280	4.00	13,291
Shop Equipment	394.2	14,916	-	14,916	4.00	597
Tools & Other	394.3	2,490,889	-	2,490,889	4.00	99,636
Lab Equipment	395	318,993	-	318,993	4.00	12,760
Power Operated Equipment	396	26,896	-	26,896	7.69	2,068
Communication Equipment	397	2,336,315	-	2,336,315	6.67	155,832
Communication Equipment - AMR Devices	397.35	16,369,745	-	16,369,745	6.67	1,091,862
Miscellaneous Equipment	398	93,907	-	93,907	6.67	6,264
TOTAL		$1,020,322,342	$14,810,191	$1,035,132,533		$22,683,661

Disallowed Depreciation @ DTE 05-27 - Palmer (3)	(1,655)
Additional Depreciation - AMR lease buyouts (3)	149,093
Net Salvage (4)	1,291,816
Amortization of Regulatory Liability (5)	(5,283,554)
TOTAL PRO FORMA DEPRECIATION EXPENSE	$18,839,361
TEST YEAR DEPRECIATION EXPENSE	36,474,724
DEPRECIATION EXPENSE ADJUSTMENT	**($17,635,363)**

(1) Exhibit RR-AG-46, Schedule JTG-7, page 2
(2) Exhibit AG/MJM-10-A
(3) Exhibit RR-AG-46, Schedule JTG-7, page 1
(4) Exhibit AG/MJM-4, page 3
(5) Exhibit AG/MJM-10-B, page 2

BAY STATE GAS COMPANY
D.P.U. 12-25
TAXES OTHER THAN INCOME TAXES EXPENSE ADJUSTMENTS
FOR THE TEST YEAR ENDED DECEMBER 31, 2011

Property Taxes (1)			ADJUSTMENT AMOUNT
ANNUALIZED PROPERTY TAXES		$14,191,436	
Less: Utility Property Tax Expense in 2011		(13,159,299)	
Total Property Tax Adjustment		1,032,137	
Plus: AMR Buyout Addition		38,901	
Less: Non-Utility Property Taxes		(32,067)	
TOTAL PROPERTY TAXES ADJUSTMENT			$1,038,971

Payroll Taxes (2)	Taxable for Social Security	Taxable for Medicare	
Gross Labor Per Annual Report	$45,893,826	$45,893,826	
Gross Payroll Tax	2,558,322	638,599	
2011 Experience Factor	5.57%	1.39%	
Adjust Test Year Data to Expected Capital Ratio			
2011 Expense Ratio	75.32%	75.32%	
Calculated Payroll Tax Expense	1,926,928	480,992	
2012 Expense Ratio	75.95%	75.95%	
Normalized Payroll Tax Expense Before Payroll Adjustments	1,943,045	485,016	
Adjustment to Test Year for Expected Capital Ratio	16,117	4,023	
Calculated Taxes Associated with O&M Payroll Adjustments			
Union & Non-Union Payroll Expense (3)	747,934	747,934	
Incentive Adjustment	(474,893)	(474,893)	
Total Payroll O&M Adjustments	273,041	273,041	
Payroll Adjustment Impact on Taxes	15,220	3,799	
Net Adjustment	31,338	7,822	
			39,160
TOTAL TAXES OTHER THAN INCOME TAXES EXPENSE ADJUSTMENT			**$1,078,132**

(1) Exhibit RR-AG-46, Schedule JTG-9, page 2
(2) Exhibit RR-AG-46, Schedule JTG-9, page 5
(3) Attachment 4

BAY STATE GAS COMPANY
D.P.U. 12-25
RATE BASE CALCULATION
FOR THE TEST YEAR ENDED DECEMBER 31, 2011

Rate Base	**Per Books**	**Adjustments**	**Pro Forma (1)**
Additions:			
Utility Plant in Service	$1,488,350,157	($444,412,163)	$1,043,937,994
Special Fund - Acct 128 Heel Gas (2)	1,992,602	(1,992,602)	-
Cash Working Capital	11,686,939	(1,726,913)	9,960,026
Material & Supplies	4,653,475	470,091	5,123,566
Total Additions	1,506,683,173	(447,661,586)	1,059,021,587
Deductions:			
Accumulated Depreciation (3)	442,810,272	1,599,488	444,409,760
Accumulated Amortization of Intangible Plant	150,989,057	(148,139,363)	2,849,695
Accumulated Deferred IncomeTaxes (4)	145,683,724	2,095,636	147,779,360
Unamortized Pre-1971 ITC	-	-	-
Customer Advances	31,696	-	31,696
Customer Deposits	3,695,872	(44,295)	3,651,577
Unclaimed Checks	139,672	-	139,672
Total Deductions	$743,350,294	($144,488,534)	$598,861,761
TOTAL RATE BASE	$763,332,879	($303,173,053)	$460,159,826

(1) Exhibit RR-AG-46, Schedule JTG-13
(2) Exhibit AG/DJE, Schedule 1
(3) Attorney General's Brief, pages 52-54
(4) Attorney General's Brief, pages 59-60

BAY STATE GAS COMPANY
D.P.U. 12-25
INCOME TAX CALCULATION
FOR THE TEST YEAR ENDED DECEMBER 31, 2011

	Amount
Rate Base (1)	$460,159,826
Weighted Cost Of Capital (2)	6.01%
Return on Rate Base	$27,673,915
Interest Expense [Rate Base x Weighted Cost Of Debt of 2.37%] (2)	(10,910,201)
Permanent Tax Difference (3)	237,046
Amortization of Investment Tax Credit (3)	(223,932)
Amortization of Deferred Income Taxes Deficiency (3)&(4)	386,630
Taxable Income Base	$17,163,459
Taxable Income [Taxable Income Base x (1 / (1 - 0.39335)]	$28,240,986
Mass State Franchise Tax (6.50%)	$1,835,664
Federal Taxable Income	$26,405,321
Federal Income Tax Calculated	$9,241,863
Total Income Taxes Calculated	$11,077,527
Amortization of Investment Tax Credit (3)	(223,932)
Amort of Deferred Income Taxes Deficiency (3)	386,630
TOTAL INCOME TAXES	**$11,240,225**

(1) Attachment 7
(2) Attachment 10
(3) Exhibit CMA/JTG-1, Schedule JTG-26, page 8, Revision 3
(4) Exhibit AG/DJE, Schedule DJE-3

BAY STATE GAS COMPANY
D.P.U. 12-25
CASH WORKING CAPITAL ALLOWANCE
FOR THE TEST YEAR ENDED DECEMBER 31, 2011

Description	Amount
Pro Forma Operations and Maintenance Expenses (1)	$129,633,828
Bad Debt Write-offs Included in CGA (2)	4,432,678
DSM Implementation (2)	17,289,828
ERC Remediation (2)	2,023,080
Pension/PBOP (2)	8,384,870
Regulatory Amortization (2)	10,720
Unbilled Related to LDAC Expense (2)	-
Bad Debt Expense In Cost Of Service (3)	4,744,529
Cash Working Capital Operations and Maintenance Expenses	$92,748,122
Taxes Other Than Income Taxes (1)	16,818,172
Total Costs Subject To Cash Working Capital Allowance	$109,566,294
Net Lead / Lag Day Factor (4)	9.090%
CASH WORKING CAPITAL ALLOWANCE	**$9,960,026**

(1) Attachment 2
(2) Exhibit RR-AG-46, Schedule JTG-13, page 4
(3) Exhibit RR-AG-46, Schedule JTG-6, page 8 less Attachment 1 (Revenue Deficiency x 0.0198)
(4) Exhibit AG/DJE-4

BAY STATE GAS COMPANY
D.P.U. 12-25
CAPITAL STRUCTURE
FOR THE TEST YEAR ENDED DECEMBER 31, 2011

	Percent Of Total (1)	Cost Rate (2)	Weighted Cost Rate
Long-Term Debt	50.77%	4.67%	2.37%
Common Equity	49.23%	7.40%	3.64%
TOTAL	**100.00%**		**6.01%**

(1) Exh. AG/JRW-1, pp. 17-18.
(2) Exh. AG/TN-1, Att. B and Attorney General's Brief, pages 185-187.