BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

National Grid PLC and KeySpan Corporation - Proposed Merger

Case 06-M-0878

The Brooklyn Union Gas Company d/b/a KeySpan Energy Delivery New York - Gas Rates

Case 06-G-1185

KeySpan Gas East Corporation d/b/a KeySpan Energy Delivery Long Island - Gas Rates

Case 06-G-1186

January 2007

Prepared Testimony of:
Accounting Rates Panel (KEDLI)

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Public Utilities Auditor I

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Q. Please state your name and business address.
A. My name is Ronald F. Calkins. My business address is Three Empire State Plaza, Albany, NY, 12223.
Q. By whom are you employed and in what capacity?
A. I am employed by the Department of Public Service as a Supervisor, in the Office of Accounting and Finance.
Q. What is your education and business experience?
A. I graduated from Siena College with a BBA in Accounting. In June of 1969, I joined the Department of Public Service.
Q. Have you previously testified before the Public Service Commission (Commission)?
A. Yes. I have testified before the Commission in various electric, gas and telephone rate proceedings.
Q. Please state your name and business address.
A. My name is Richard M. Brash. My business address is Three Empire State Plaza, Albany, NY, 12223
Q. By whom are you employed and in what capacity?

A. I am employed by the Department of Public Service as a Public Utilities Auditor III, in the Office of Accounting and Finance.

Q. What is your education and business experience?

A. I graduated from the State University of New York at Albany in 1976 with a Bachelor's Degree in Business Administration. Since joining the staff of the Department of Public on October 1980, I have worked on rate and finance proceedings of electric, gas, telephone and water companies.

Q. Have you previously testified before the Commission?

A. Yes, I have testified in rate proceedings before the Commission.

Q. Please state your name and business address.

A. My name is George Abraham. My business address is 90 Church Street, New York, NY, 10007.

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

A. I am employed by the New York State Department of Public Service as a Public Utilities Auditor II, in the Office of Accounting and Finance.

Q. Please state your educational and professional background experience.

A. I graduated from Sri Venkateswara University, India in 1978 with a Masters of Arts Degree in Commerce. I have been on the audit staff with the Department of Public Service since March 1982.

Q. Have you previously testified before the Commission?

A. Yes.

Q. Please state your name and business address.

A. My name is Christopher G. Simon. My business address is Three Empire State Plaza, Albany, NY, 12223.

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

A. I am employed by the Department of Public Service as a Public Utilities Auditor I, in the Office of Accounting and Finance.

Q. What is your educational and business experience?

A. I attended the State University of New York Institute of Technology at Utica/Rome where I graduated with a Bachelor in Accounting and a

Master in Business Administration with a Concentration in Accounting. I worked for 2½ years at Warren Koch, PC, Croton-On-Hudson, NY. At Warren Koch PC, I worked as an Accountant and as the Network Administrator. After Warren Koch, I went to LCS&Z, LLP in Latham, New York where I was employed as an Accountant. In February 2005, I joined the Office of Accounting and Finance in the Department of Public Service in my present position.

Q. Have you previously testified before the Commission?

A. Yes, I have filed testimony as a part of the Accounting Rates Panel for Corning Natural Gas Corporation in Cases 05-G-1359, 05-G-1268 and 04-G-1032.

Q. What is the purpose of the Accounting Rate Panel (Panel or Staff) testimony in this proceeding?

A. The Panel participated in the examination of the KeySpan Energy Delivery of Long Island (KEDLI or Company) rate case filing, the supporting work papers, books, records and accounts of the Company and its affiliates. The Panel will propose specific adjustments to the Historic Test Year, Amortization Expense, Sales Promotion Expense, Other Employee Related Expenses, Inflation Percentage Factor, Labor, Payroll Taxes and Operations and Maintenance Expenses.

Q. Has the Panel prepared any exhibits to be presented in this case?

A. Yes. The Panel is sponsoring Exh___(ARP-1) Schedule A, Pages 1 Through 13. Schedule A contains the following data:

- Statement of Operating Income, Rate Base, and Rate of Return - Page 1 of 13;
- Operations & Maintenance Expense - Page 2 of 13;
- Depreciation - Page 3 of 13;
- Amortizations - Page 4 of 13;
- Taxes Other Than Income Taxes - Page 5 of 13;
- State Income Taxes - Page 6 of 13;
- Federal Income taxes - Page 7 of 13;
- Calculation of Interest Expense - Page 8 of 13;
- Calculation of Average Rate Base - Page 9 of 13;

- Capitalization Earnings Base Comparison - Page 10 of 13;
- Computation of Cash Working Capital Allowance - Page 11 of 13;
- Company Proposed Capital Structure, Staff Proposed Capital Structure - Page 12 of 13;
- Computation of Recommended Additional Revenue Requirement - Page 13 of 13;

Exh___(ARP-1) Schedule B, Pages 1 through 2. Schedule B contains the description of Staff's adjustments.

Exh___(ARP-1) Schedule C, Pages 1 through 13. Schedule C contains the following data:

- DPS-120 - Page 1 of 13;
- DPS-264 - Page 2 of 13;
- 15 Month Inflation Estimate - Page 3 of 13;
- Blue Chip Economic Indicators Vol. 32, No. 1 January 10, 2007 - Pages 4 & 5 of 13;
- DPS-312 - Pages 6-13 of 13

Q. Please describe the pages in Schedule A of Exh__(ARP-1).

A. Schedule A is Staff's Income Statement and Rate of Return calculation for KEDLI before and after our revenue requirement recommendation for the rate year ended March 31, 2008. Schedule A - page 1 of 13, is Staff's Statement of Operating Income, Rate Base and Rate of Return. The First column in Schedule A corresponds to the KEDLI Rate Year figures as presented in the Company's Rate Filing. The second column reflects Staff's adjustments. Exh___(ARP-1) Schedule B contains the descriptions of all adjustments made in the second column. The third column is the sum of columns one and two. The fourth column reflects Staff's proposed Revenue Requirement. Finally, column five represents the sum of columns three and four. Staff is proposing a gas base rate increase of $61.137 million, a 4.61% increase in the total bill.

Q. What other data is shown in Exhibit ___(ARP-1), Schedule A Page 2 through 13?

A. Schedule A, Page 2 of 13, shows the Operation and Maintenance expenses as adjusted by Staff. Schedule A, Page 3 of 13, shows the Depreciation Expense as adjusted by Staff. Schedule A, Page 4 of 13, shows the Amortizations as adjusted by

Staff. Schedule A, Page 5 of 13, shows the Taxes Other Than Income Taxes as adjusted by Staff. Schedule A, Page 6 of 13, shows the calculation of the New York State Income Taxes as adjusted by Staff. Schedule A, Page 7 of 13, shows the calculation of Federal Income Taxes as adjusted by Staff. Schedule A, Page 8 of 13, shows the Calculation of Interest Expense as adjusted by Staff. Schedule A, Page 9 of 13, shows the average Rate Base as adjusted by Staff. Schedule A, Page 10 of 13, shows the Historic Earnings Base Capitalization Comparison as adjusted by Staff. Schedule A, Page 11 of 13, shows the Cash Working Capital allowance as adjusted by Staff. Schedule A, Page 12 of 13, shows the proposed Capital Structure and Rate of Return as filed by the Company as well as Staff's proposed Capital Structure and Rate of Return. Schedule A, Page 13 of 13, shows Staff's computation of its recommended additional Revenue Requirement for the twelve months ending March 31, 2008.

Q. Please describe the pages in Schedule B of Exh___(ARP-1).

A. On Pages 1 and 2 are brief descriptions of the Staff adjustments to Operating Revenues, Operations and Maintenance Expense, Depreciation, Amortizations, State and Federal Income Taxes, Interest Deduction, Rate Base/Capitalization, Cash Working Capital and the Capital Structure.

Q. Please describe the pages in Schedule C of Exh___(ARP-1).

A. Schedule C - Page 1 of 13, was Staff's interrogatory requesting the cost component schedule for the year ended December 31, 2004 and 12 months ended September 30, 2006. Schedule C - Pages 2 of 13, was Staff's interrogatory requesting the cost component schedule for the years ended December 31, 2003 & 2006. Schedule C - Page 3 of 13, is Staff's updated inflation estimate used to calculate the new Rate Year Expense. Schedule C - Pages 4 & 5 of 13, contains the updated GDP Deflators for 2007 and 2008 as provided by Blue Chip Economic

Indicators Vol. 32, No. 1 January 10, 2007. Schedule C - Pages 6 - 13 of 13, was Staff's interrogatory requesting further information on Pension and OPEB's.

AMORTIZATION EXPENSE

Q. Has the Panel addressed the company's amortization and recovery of Merger Costs from the Brooklyn Union Gas/LILCO merger?

A. Yes. The Company has reflected in operating expense a $1,971,000 Merger Cost amortization as shown on Company Exhibit PJM-3, Schedule 1, Page 1. As outlined within the merger case settlement agreement (Case 97-M-0567, Opinion 98-9, issued and effective April 14, 1998) the parties agreed to permit the Company to amortize the allowed combination costs over a ten year period beginning in 1998. The ten year amortization period will be completed during the rate year. Once the merger costs are fully recovered, the remaining merger cost revenue requirement collections should thereafter be used to offset the deferred SIR costs.

Q. Has Staff adjusted the Company's amortization of environmental costs?

A. Yes. The Company's rate case operating expenses increased by $6,645,000 to reflect a seven-year amortization of Deferred Site Investigation and Remediation costs (SIR) associated with the former gas manufactured sites located within KEDLI's service territory. This calculation is based on a seven-year amortization assuming total unrecovered deferred cumulative SIR costs, net of insurance recoveries, of $46,513,000 as of March 31, 2007. This forecasted amount of cumulative deferred SIR costs is far greater than the actual deferred costs of $19,357,898 at December 31, 2005 and $24,436,094 at September 30, 2006. Due to the large disparity between the actual and forecasted balances, we recommend a ten-year amortization period for deferred SIR costs. The ten-year amortization period was selected because it has been approximately ten years since the last rate change (Case 97-M-0567, Opinion No. 98-9, Issued and Effective April 14, 1998). This adjustment lowers the

Company's rate year amortization by $4,201,000 (Adjustment 16). The SIR deferral balance and the associated amortization level should be updated during the course of this proceeding.

SALES PROMOTION EXPENSE

Q. How is Staff proposing to adjust the Sales Promotion Expense?

A. Based on Staff witness Sorrentino's testimony, the Sales Forecast expense for KEDLI will be reduced by $5.250 million (Adjustment 4).

Q. Why is this done?

A. According to witness Sorrentino's sales forecast, the sales promotion enhancements to the equipment and the rebate and financing programs that KeySpan is proposing will not be needed to achieve Staff's sales forecast.

OPERATIONS AND MAINTENANCE EXPENSE

Q. What is the first change that Staff is proposing for the Company's initial filing?

A. Staff is proposing to update the inflation pool expense items from the Historic Test Year December 31, 2005 to the Historic Test Year December 31, 2006.

Q. What is the rationale for updating the Historic Test Year?

A. During the initial investigation into the books and records supporting KEDLI's Historical Test Year ended December 31, 2005, we compared Operations and Maintenance expense levels for that time period to those in 2003, 2004 and preliminary results in 2006. Results for the year ended December 31, 2004 and the 12 months ended September 30, 2006 were obtained from interrogatory DPS-120 Exh___(ARP-1), Schedule C - Page 1 of 13. Results for December 31, 2003 as well as an updated year ended December 31, 2006 (received January 15, 2007) were obtained from DPS-264 Exh___(ARP-1), Schedule C - Page 2 of 13. These requested schedules provided Staff with a historical trend of the Operations and Maintenance Expenses and indicated that total expenses increased from 2003 to 2004 by $15,026,814 or 11.32%, decreased from 2004 to 2005 by ($6,057,181) or (-4.10%) and then increased from 2005 to 2006 by $2,503,449 or 1.77%. Staff decided to take the more current year expenses over the outdated historic test year. The update to the Historic Test Year results in an overall increase of the inflation pool expenses in the Operations and Maintenance Expense accounts by $970,381.

Q. Has Staff made any specific adjustments to the updated Historic Test Year based on the Company's books and records?

A. Yes, Other Related Employee Expense included a one time expense recorded in March 2006 of $456,822 related to a Stock Option bonus for Mr. Robert Catell based on the Company's overall 2005 financial performance. This amount was to have been recognized over the course of 2 years, but due to recent FASB regulations, the Company's accountants recorded the expense in 2006. Staff has eliminated this amount from the Updated Historic Test Year for the purpose of forecasting the 2008 Rate Year Expenses. Examination of this account from 2003 through 2006 shows this as a one-time event and there is no basis for assuming that this will occur during the 2008 Rate Year. For the year 2005, KEDLI's earnings, were not in excess of the 11.10% sharing threshold that would have allowed the customers to benefit by receiving a portion of the excess earnings achieved by the Company. Staff believes that since the customers did not benefit from KEDLI's 2005 financial performance, it is unreasonable to have customers fund any part of an executive bonus. This adjustment reflects a ($.457) million reduction to Other Related Employee Expense for the 2006 Historic Test period.

Q. Did Staff have to make any other adjustments to the original filing after updating the Historic Test Year to the calendar year 2006?

A. Yes, Staff updated the inflation factor to reflect the more up-to-date Historic Test Year. The Company used a 27-month inflation factor to update the Historic Test Year December 31, 2005 filing to the Rate Year March 31, 2008. When Staff reflected the actual data for calendar year 2006, a 15-month inflation factor was necessary to forecast expenses to March 31, 2008. The new 15-month inflation factor is

2.61%, Exh___(ARP-1) Schedule C - Page 3 of 13, versus the 27 month inflation factor of 5.57%. Lowering the inflation factor results in a reduction of Rate Year Operations and Maintenance Expense by ($1,237,008).

Q. What schedules were presented in the original filing that show the Company's inflation factor?

A. The two schedules were the Company's Cost Adjustment Factors Reflecting Changes in Inflation Estimates for a 27 Month Period Schedule (Exhibit 4, JFB-4, Schedule 3, Page 2 of 2) and the supporting Cost Adjustment Factors Reflecting Changes in Price Levels March 2009 Through March 2012 Rate Year Schedule (Exhibit 4, JFB-10, Schedule 1 - Page 2 of 4).

Q. How were these schedules used in the Rate filing?

A. JFB-4 calculated the escalation factor used to inflate the 2005 expenses to the March 31, 2008 Rate Year levels. JFB-4 shows information for the time period from the third quarter 2005 through the third quarter 2007. The third quarter 2005 was based on the actual reported

GDP Deflator and the remaining quarters were all forecasted. JFB-10 has the GDP Deflator forecasts for the period fourth quarter 2007 through third quarter 2011. Forecasted GDP Deflators were supplied by Blue Chip Economic Indicators - Vol. 30, No. 10, October 10, 2005.

Q. Did Staff update the GDP Deflators reflected in JFB-10 to a more recent estimate then the percentages provided as of October 10, 2005?

A. Yes, Staff received an updated forecast of GDP Deflators for the four quarters 2007 and the four quarters 2008 as provided by Blue Chip Indicators - Vol. 32, No. 1, January 10, 2007. Exh__(ARP-1) Schedule C Page 5 of 13.

Q. What change did Staff make to schedule JFB-4 in order to calculate the 2.61% inflation factor?

A. Staff first updated the time period between the Historical Test Year and the Rate Year. As stated earlier, Staff is proposing to update the Historic Test Year from the year ending December 31, 2005 to the year ending December 31, 2006. This decreased the period of time between Historical Test Year and the Rate Year from 27 months to 15 months. The Company originally used the time period of the third quarter 2005 through the third quarter 2007 as the basis for calculating the inflation rate. This calculation incorrectly accounts for the third and fourth quarters of 2005, which would have already been accounted for in the actual expense in 2005. Staff used the format as provided in JFB-4 and the updated forecasted GDP Deflators for the 15 month period spanning from the first quarter 2007 through first quarter 2008. This time period encompassed the actual period of time between the updated historic test year and the rate year.

Q. Is Staff including any expenses in the new inflation pool that were not originally adjusted for inflation in KEDLI's original filing?

A. Yes, we include Health and Hospitalization in the general inflation pool. For decades, the Commission has included Health Care costs in an expense group to which an overall inflation index is applied. On occasion, utility companies have sought to apply a separate and higher cost escalation factor to the Health Care costs. However, the Commission has consistently rejected any such change to this approach. KEDLI claims that a separate inflator is need for Health Care costs given very large medical increases in recent times. We reject this argument and support the Commission's established practice. We also point out that some items to which the general inflation index is applied will exceed the index and some will fall below the rate of inflation. We believe that the standard ratemaking practice, which applies a general inflation factor to Health Care costs, and other cost categories, remains valid in today's circumstance and prevailing conditions.

Q. Is Staff proposing any other adjustment to non-inflation pool expense items due to the Updated Historical Test Year?

A. Yes, we propose to increase the Labor expense in the Updated Historic Year but lower the rate of change associated with the projection of this expense to the Rate Year. The Company originally showed Labor expense of $55,439 million in the Historic Test Year and then applied a composite increase (based on various Union Agreed Labor increases and Management increases) of 8.54%, resulting in a rate Year expense of $60,176 million. Staff proposes to use the Updated Historic Labor expense of $61,251 but apply a lower percentage increase. Staff's proposed increase is 4.74%. Staff started with the original composite increase of 8.54% and used 15/27th of the increase. The 15/27th is the remaining time period between the Updated Historic Test Year and the Rate Year (15 months) versus the Original Historic Test Year and Rate Year (27 months) and it results in an increase in Labor expense in the Rate Year of $3.978 million.

Q. With the proposed increase of payroll expense, do you have an associated adjustment to payroll taxes?

A. Yes, Staff has updated the Payroll Taxes to reflect the new Updated Historic Test Year ending December 31, 2006. The Company originally forecasted an increase in Payroll Taxes from the Historic Test Year to the Rate Year of 8.29%. Applying the same 15/27th as proposed with Labor, Staff increased the Updated Historic Test Year expense by 4.61%, resulting in an increase of Payroll Tax expense in the Rate Year of $.625 million.

Q. Is Staff' updated inflation estimate lower than the Company's estimate for the period between the Historic Test Year and the Rate Year?

A. Yes, Staff's Inflation Estimate is lower. The combination of a lower Inflation Estimate, higher total Operations and Maintenance expense, one time adjustment to Other Employee Related Expense Benefits, and increases in Labor and Payroll Taxes results is an increase in Operations and Maintenance expense of $3,880,286. (Adjustment 6)

Q. Does Staff have any other adjustments to operations and Maintenance Expense?

A. Yes, Staff is proposing a 1% productivity adjustment on all updated Operations and Maintenance expense. The 1% productivity adjustment is composed of two separate adjustments. The first adjustment is based on the Commission's commonly reflected 1% labor savings adjustment for all forecasted rate years. This adjustment is applied to the following expenses: Labor, Health and Hospitalization, 401K match, OPEB's, Payroll Taxes and Pensions. The second adjustment applies the 1% factor to the remaining expenses.

Q. The Commission commonly reflects a labor productivity savings in the forecast Rate Year. Did KEDLI reflect productivity savings in the Rate Year?

A. No, there is no productivity adjustment reflected in the KEDLI filing.

Q. Why did KEDLI not reflect any labor productivity adjustments?

A. Mr. Bondaza states (Page 7) that "It is my understanding that in calculating recoverable labor expense for the ratemaking purpose, the Commission's practice is to apply a 1% productivity adjustment that reduces recoverable labor expense. Given KeySpan's cost control efforts in the past, there is no justification for applying this adjustment in this proceeding. KeySpan has already voluntarily achieved the savings that are imputed through the productivity adjustment."

Moreover, Company witness McClellan states (Page 11) that, "As explained in Mr. Bodanza's testimony, KEDLI has done an extraordinary job in controlling O&M expenses since the Brooklyn Union/LILCO merger. As an example, in the Test Year for KEDLI's June 30, 1992 rate filing, the O&M labor expense was $54,380,000 (PSC Case No. 93-G-002). The December 2005 Test Year Labor Expense was %55,479,000. This represents a 1.9% increase in expense despite thirteen years of wage increases. Given this performance, it would be unreasonable to impute additional labor productivity in the determination of Company's Rate."

Q. Does Staff agree with this position?

A. No. Productivity adjustments are designed to reflect the forecasted payroll levels that drive expenses during the Rate Year. KEDLI's past performance shows that they should be able to continue this trend of cost savings. The 1% productivity adjustment reduces labor by ($1,023) million. (Adjustment 7)

Q. What is the basis for Staff's proposal of applying a 1% productivity adjustment on the remaining expenses not already factored into the Labor Adjustment?

A. The Operation and Maintenance Expense information in Exhibit 4, JFB-14, Schedule 1, Page 1 of 2, indicates that KEDLI has seen increases in expenses from 2001 through 2005 at a rate that was less then inflation. While KEDLI requests a rate increase based on the use of inflation to escalate most non-commodity Operations and Maintenance expense they have contended that: "… the provision of service through a service company structure, along with KeySpan's other rigorous cost control efforts, has enabled KeySpan to hold its operations and Maintenance ("O&M") expense below the rate of general inflation over the past several years," (Mr. Bodanza (Page 3)). Staff would capture the continuation of this cost savings through the 1% productivity adjustment, which is generally consistent with the Company's recent experience. The effect of this adjustment is a decrease of ($.563) million in Operations and Maintenance Expense. (Adjustment 8)

Q. What is the total change in Operations and Maintenance Expense after all adjustments?

A. The total adjustment to Operations and Maintenance is an increase of $2,293,723.

ACCOUNTING AND RATEMAKING FOR PENSION AND OPEB'S

Q. Does the Commission have a policy with respect to the accounting and ratemaking for Pension and Postretirement Benefits Other than Pensions (OPEB's) Benefit Plans?

A. Yes. In 1993, the Commission issued a Statement of Policy and Order Concerning the Accounting and Ratemaking for Pension and Postretirement Benefits Other Than Pensions (SOP) (Case 91-M-0890, issued September 7, 1993) that remains in effect today.

Q. What are some of the key provisions of the SOP?

A. A key provision of the SOP is that utilities must defer the difference between their actual Pension/OPEB expense and the amount allowed in rated for Pension/OPEB expense for future Commission disposition. The SOP also provides that the amount of Pension/OPEB rate allowance not be deposited into an external trust, or paid out in benefits, or be accounted for using the internal reserve method. It also requires that companies provide notification should they settle, curtail or terminate an employee benefit plan, or any portion of an employee benefit plan. Finally, there is a provision against the commingling of Pension/OPEB monies provided by NYS ratepayers with funds from other affiliates in a consolidated group.

Q. Is KEDLI subject to the various provisions of the Commission's SOP?

A. Yes, in their entirety.

RATE YEAR PENSION AND OPEB EXPENSE ALLOWANCE

Q. In its initial filing, how much did KEDLI request as a rate allowance for Pension and OPEB expense?

A. The Company requested rate allowances of $12,125,000 and $13,812,000 for Pension and OPEB expense, respectively.

Q. Did the Company propose to revise its initial forecast of Pension and OPEB expense during the Staff discovery period?

A. Yes. In its supplemental direct testimony filed on January 10, 2007, the Company proposed a reduction of $2,041,000, from $12,125,000 to $10,084,000, to its forecast of Rate Year Pension expense, and a reduction of $1,399,000, from $13,812,000 to $12,413,000, to its forecast of Rate Year OPEB expense.

Q. Are you proposing to reflect these reductions in your forecast of Rate Year Pension and OPEB expense?

A. Not at this time.

Q. Please explain why not.

A. The Company did not provide any support at all for these updates and as a result they can not be properly evaluated. We promptly submitted an information request asking the Company to explain and support the revisions. Should updates to the Rate Year forecasts be warranted we will recommend them as appropriate.

AMORTIZATION OF DEFERRED PENSION AND OPEB EXPENSE

Q. In its initial filing, did KEDLI request to amortize deferred Pension and OPEB expenses?

A. Yes. The Company proposes to amortize, over a seven-year period, deferred Pension and OPEB expenses of $47,803,000, or $6,829,000 on an annual basis. The net deferred expense of $47,799,921 consists of $26,923,667 of claimed deferred Pension and OPEB expense as of December 31, 2005, plus a projected additional deferred expense of $20,876,254 for the period between January 1, 2006 and March 31, 2007.

Q. Did the Company propose to revise its initial estimate of deferred Pension and OPEB expense during the Staff discovery period?

A. Yes. In its supplemental direct testimony filed on January 10, 2007, the Company reduced its estimate of deferred Pension and OPEB expense which it seeks to recover by $4,147,921, from $47,799,921 to $43,652,000, (or $593,000 on annual basis, from $6,829,000 to $6,236,000).

However, the Company did not provide any evidence in support of that revision.

Q. Has the Commission yet approved a disposition of deferred Pension or OPEB expense for KEDLI?

A. No. An examination of KEDLI's deferred Pension and OPEB expense and the account balance from which this expense is estimated has never occurred.

Q. Have you been able to verify the balance in the Company's deferred Pension and OPEB expense account?

A. No.

Q. Please explain.

A. We have encountered numerous difficulties verifying KEDLI's deferred Pension and OPEB expense accounts. To begin with, the Company has not yet provided any information concerning its Pension and OPEB expense deferral activity for the period between January 1, 1993 and December 31, 1998. In DPS-312 Exh___(ARP_1), Schedule C - Pages 6 - 13, we asked for this particular information and the Company simply did not provide it.

KEDLI also has not sufficiently supported the annual allocation of Pension and OPEB costs from the KeySpan service companies to KEDLI. A significant part of KEDLI's annual Pension expense results from the service companies cost allocation.

Additionally, KEDLI has not explained nor supported the adjustments and/or reversals of prior period amounts to deferred Pension and OPEB expense accounts. During the fiscal years between 2000 and 2005, the Company made a number of unexplained accounting entries having a significant impact on the deferred Pension and OPEB expense balances.

KEDLI has also not explained nor demonstrated how a Long Island Pension plan settlement in fiscal year 2000, affected the Pension expense of KEDLI in that period. In addition to not providing proper notification of the settlement as required by the SOP, it has not shown how the gains that resulted from the settlement were reflected in the Pension expense deferral for customer benefit.

Further, it has not explained or demonstrated how special termination benefits paid in several years (e.g. fiscal year's 2000, 2001 and 2005) effected KEDLI's Pension and OPEB assets, obligations and net periodic benefit cost in each of those years as well as future years.

Moreover, it has not shown how the savings (i.e. expense reduction plus the related tax benefits) resulting from the Medicare Act of 2003 was reflected in the deferred OPEB expense balance.

Finally, the Company has not established Pension and OPEB internal reserves to account for the differences between (1) the actual amounts funded and (2) the sum of the rate case expense allowance plus the actual amount capitalized on the Company's books for Pension and OPEB'S as required by SOP. In DPS-312, we asked the Company to provide its Pension and OPEB internal reserve accounting and it did not provide any information whatsoever indicating that its accounting complied with SOP requirements.

Q. What are you proposing?

A. We are proposing that the Commission establish a separate proceeding to resolve the issues and problems uncovered here so that the KEDLI's accounting for Pension and OPEB'S can thoroughly examined for accuracy and be brought into line with the all various requirements of the SOP. The accounting issues are complex in nature, cover a twelve-year period (i.e. January 1, 1993 through December 2005) and require significantly more time than is available during the normal discovery period of a rate case. In its filing, the Company provided little evidence in support of its deferred accounting for Pension and OPEB expense and provided no evidence concerning its Pension and OPEB internal reserve accounting. Although the Company has provided some information in response to our information requests, more detailed information is needed to assure the Commission that the Company's accounting for Pension and OPEB'S is accurate and is in full compliance with the SOP. The Merger Policy Panel addresses the implications of this issue on the proposed merger transaction in its testimony.

Q. Did KEDLI include unamortized deferred Pension and OPEB expense in its Historic Test Year Rate Base and Rate Year Rate Base?

A. Yes.

Q. Do you agree with its inclusion?

A. No.

Q. Please explain why not.

A. Deferred Pension and OPEB expense is a non-cash deferral which represents the difference between the amount allowed in rates for Pension/OPEB expense and the actual amount recorded as Pension/OPEB expense on the Company's books. Since the amount recorded is not a cash expense, it is a non-cash accrual with no supporting capitalization, its inclusion in the Historic Test Year Rate Base creates a mismatch between Rate Base and the capitalization supporting Rate Base. Accordingly, the Deferred Pension and OPEB expense of $45,667,000 less the associated accumulated Deferred Federal Income Taxes of $15,984,000 and the Deferred State Income Tax expense of $4,124,000 for a total of $25,559,000 (Adjustment 33) should be removed from the Historic Test Year Rate Base.

For the same reason that the Pension and OPEB deferrals should not be included in the Historic Test Year Rate Base for earning base versus capitalization purposes (i.e. the deferrals are non-cash transactions and therefore not supported by capitalization), the Deferred Pension and OPEB expense of $61,309,000 (Adjustment 25) and the associated accumulated Deferred Federal Income Tax expense of $21,459,000 and Deferred State Income Tax expense of $5,535,000 for a total of $26,994,000 (Adjustment 28) also must be removed from the Rate Year Rate Base.

Q. Did KEDLI add in any other accounts into the deferred Pension and OPEB expense account balance?

A. Yes. The Company incorporated amounts associated with its unamortized OPEB transition obligation.

Q. Do you agree with its inclusion?

A. No. For the identical reasons stated above for deferred Pension and OPEB expense (i.e. the unamortized transition obligation is non-cash and therefore not supported by capitalization) this amount was removed from both the Historic Test Year Rate Base and Rate Year Rate Base within the Deferred Pension and OPEB expense adjustment.

Q. Please summarize your adjustments related to deferred Pension and OPEB expense.

A. We have eliminated the Company's initial request for a Rate Year amortization of $6,829,000 (Adjustment 11) related to deferred Pension and OPEB expense until we can assure the Commission that the Company's accounting for its Pension and OPEB benefits plans is accurate and is in compliance with its SOP.

We also removed $45,667,000 from the Company's Historic Test Year Rate Base, and

$61,309,000 from its Rate Year Rate Base to remove the non-cash deferrals (i.e. deferred Pension and OPEB expense as well as the unamortized OPEB transition obligation) that are not supported by capitalization.

PREPAID PENSION EXPENSE

Q. Did KEDLI include prepaid Pension expense in its Historic Test Year Rate Base and Rate Year Rate Base?

A. Yes.

Q. What reason did the Company provide for carrying a prepaid Pension expense balance?

A. Company witness Bodanza claims that KEDLI has a prepaid Pension expense because it has made cash contributions to its Pension in excess of its Pension expense level.

Q. Do you agree with its inclusion in the Company's revenue requirement?

A. No.

Q. Please explain.

A. Mr. Bodanza's description of prepaid Pension expense and what accumulates in it is inaccurate. It is not simply the cash prepaid expense described by Mr. Bodanza but rather the balance sheet effect that also results from the accrual of negative Pension expense. Mr. Bodanza has not recognized that KEDLI's prepaid pension position was also due to the fact that KEDLI had negative Pension expenses in a number of fiscal years that are reflected in the prepaid Pension expense balance. The inclusion of the prepaid expense balance is an issue because KEDLI is effectively seeking to include the balance in its Rate Base.

Q. Is there a cash side of the Pensions and OPEB issue for ratemaking purposes?

A. Yes. Cash enters the picture when the Company actually contributes monies to its Pension and OPEB trusts. The difference between (1) the actual amounts funded and (2) the sum of the rate case expense allowance plus the actual amount capitalized on the Company's books for Pension and OPEB'S is handled through the Pension and OPEB internal reserve established in accordance with the SOP. As discussed on page 19 therein, the Commission considered Rate Base treatment for any such funding differentials, but decided instead to accrue carrying charges on the funding differentials in the internal reserve.

The SOP allows the accrual of carrying-charges only on credit balances in the Pension and OPEB internal reserves. It requires that companies seeking to accrue a carrying-charge on a debit balance petition for Commission approval or seek such approval in a rate proceeding.

Q. What are the balances in the Pension and OPEB internal reserve accounts?

A. As noted above, the Company has yet to establish Pension and OPEB internal reserve accounts as required by the SOP.

Q. How do you propose to adjust the Company's rate filing?

A. We are eliminating the $16,061,000 for prepaid Pension expense included in both the Historic Test Year Rate Base (Adjustment 34) and the Rate Year Rate Base (Adjustment 30). The Commission's SOP is clear and unambiguous concerning the treatment of Pension and OPEB plan funding differentials and how the Company could earn a return on any excess funding.

MEDICARE PART D SUBSIDY TAX BENEFITS

Q. Please explain your adjustment including a deduction related to the estimated rate year Medicare Part D subsidy.

A. On December 8, 2003, the Medicare Prescription Drug, improvement and Modernization Act of 2003, (ACT) was signed into law, expanding Medicare by adding a voluntary prescription drug benefit under a new Medicare Part D. To encourage employers to continue current prescription drug coverage for retirees, the federal government began in 2006, paying employers that provide a qualified retiree prescription drug plan a tax-free subsidy equal to 28% of qualifying enrollees' allowable annual prescription drug costs between $250 and %5,000 (i.e., up to $1,330).

Q. Under the ACT, when will employers recognize the tax deduction?

A. Employers will receive a tax deduction when they pay or fund retiree prescription benefits.

However, they will not be taxed on any subsidy received under the ACT. For example, an employer that pays $5,000 in prescription drug costs and receives a $1,000 subsidy related to those costs will have a $5,000 tax deduction and receive the $1,000 subsidy tax-free.

Q. Does KEDLI qualify for the employer subsidy?

A. Yes. The Company's actuary determined that the Company will qualify for the employer subsidy.

Q. Does the Company's rate year forecast of other postretirement benefits other than pensions (OPEB's) costs reflect the impact of the Medicare Part D subsidy?

A. Yes.

Q. Does the Company's revenue requirement calculation include the tax benefit associated with the subsidy payment?

A. No.

Q. Are you proposing to reflect the tax benefit associated with the subsidy in Staff's revenue requirement calculation?

A. Yes. The Company will receive a tax benefit associated with the subsidy payment under the new Medicare Part D in the rate year. Also, there is sufficient actuarial information from which to estimate the rate year subsidy payment.

Q. Please explain your adjustment.

A. We are proposing to reflect a tax benefit associated with the subsidy payment of $560,000 (Adjustment 12) in the rate year forecast of FIT expense.

Q. How did you arrive at that amount?

A. According to actuarial information, KeySpan Corporation expects to receive tax-free subsidy payments of $3.9 and $4.3 million in 2007 and 2008, respectively. Therefore, we applied an estimated consolidated rate year subsidy payment of $4 million to the percentage of fiscal year 2005 consolidated OPEB costs borne by KEDLI (14%). This is a straightforward and reasonable way to forecast the rate year subsidy payment related to the ACT.

TAXES

Q. Has the Panel reviewed the Company's State Income Tax Calculation?

A. Yes. Staff is proposing to increase taxable income by $30,397,000 due to various Staff operating revenue and operating expense adjustments. The interest expense has increased by $3,410,000 as shown in Exh____(ARP-1), Schedule A - Page 8 of 13. The various Staff adjustments produce changes to reflect the Medicare cash proceeds, and normalized items timing differences for Pension and OPEB's, Book and Tax depreciation and SIR costs and the related Deferred State Income Tax expense. The current State Income Tax expense has been increased by $390,000 from a negative ($4,509,000) to a negative ($4,119,000). The deferred State Income Tax has been increased by $1,996,000 from a positive $5,422,000 to a $7,419,000. The total State Income Tax expense has increased by $2,386,000 from $913,000 to $3,299,000.

Q. Has the Panel reviewed the Federal Income Tax calculation?

A. Yes. Staff is proposing to increase taxable income by $30,397,000 due to various staff operating revenue and operating expense adjustments. The interest expense has increased by $3,410,000 as shown in Exh____(ARP-1), Schedule A - Page 8 of 13. The various Staff adjustments produce changes to reflect the Medicare cash proceeds, and normalized items timing differences for Pension and OPEB, Book and Tax depreciation, SIR costs, SIT taxes and the related Deferred Federal Income Tax expense. The Current federal Income Tax expense has been increased by $1,376,000 from a negative ($13,967,000) to ($12,591,000). The Deferred Federal Income Tax expense has been increased by $7,039,000 from $17,185,000 to $24,225,000. The total Federal Income Tax expense has increased by $8,414,000 from $3,219,000 to $11,633,000.

Q. Has Staff adjusted the Rate Year Interest Expense?

A. Yes. As shown in Exh___(ARP-1), Schedule A - Page 8 of 13 we have reflected Staff adjustments decreasing Rate Base by ($55,011,000) (Adjustment 18) and reflected interest bearing Construction Work in Progress of $15,231,000

(Adjustment 19) to reflect a revised Earnings Base of $1,618,844,000. Applying Staff's Weighted Cost of Debt overall debt of 4.05% as reflected in the overall Rate of return of 7.93% to the Earnings Base produces an interest expense of $65,623,000.

Q. Has the Company been filing annual New York State Tax expense reconciliations?

A. Yes. The Company has been filing annual New York State Tax reconciliations since the year 2000 in compliance with the provisions of Case 00-M-1556, Issued and Effective on June 28, 2001. The annual reconciliation will have to be filed up to the date that the State Income Tax expenses are included in Base Rates within this Rate Case.

RATE BASE ADJUSTMENTS

Q. Have you adjusted the Deferred Merger cost from the Brooklyn Union Gas/LILCO merger included in rate base?

A. Yes. The Deferred Merger cost of $2,292,000, as shown on company Exhibit PJM-9, Schedule 2, page 1 of 7, is reflected as an addition to the rate year rate base. Within Mr. McCellan's testimony, he states that this amount is the projected average balance of unrecovered deferred merger costs, which were incurred during the transfer of assets between the Brooklyn Union Gas and the Long Island Lighting Company. As outlined within the merger case settlement agreement (Case 97-M-0567, Opinion 98-9, issued and effective April 14, 1998), the parties agreed to permit the company to recover the allowed combination costs, which included carrying costs over a ten-year period beginning in 1998. Allowing the deferred merger costs as an addition to rate base will provide the company an opportunity to earn a dual return, initially through a carrying charge on the deferred merger cost balance as provided within the merger settlement agreement and an additional return as a rate base component. We are removing the Deferred Merger Cost of $2,292,000 (Adjustment 23) from the rate year rate base and the associated accumulated deferred federal income taxes and state income taxes of $1,009,000 (Adjustment 27).

Q. Have you adjusted the deferred SIR expenditures included in rate base?

A. Yes. The projected Deferred SIR expenditures of $60,110,000 as shown on company Exhibit PJM-9, Schedule 2, Page 3 of 7, is reflected as an addition to the rate year rate base. This balance is the company's projection of the deferred cumulative SIR expenditures net of insurance recoveries and reflects a proposed seven-year amortization of the projected balance of $46,513,000 at March 31, 2007. In addition, the company is estimating a growth in the Deferred SIR balance of approximately $36,000,000 on an annual basis and is reflected within the $60,110,000 balance. Presently the company's forecasted deferred SIR costs are far greater than the actual deferred costs of $19,357,898 at December 31, 2005 and $24,436,094 at September 30, 2006. The company has proposed to update the deferred SIR expenditure balance during the course of the proceeding. Our proposal is to remove from the rate base, the projected Deferred SIR expenditures of $60,110,000 (Adjustment 23) and the associated accumulated deferred federal income taxes of $21,038,500 and accumulated deferred state income taxes of $5,427,933 for a total of $26,466,000 (Adjustment 26). We recommend that the actual Deferred SIR expenditures be updated at the time rates go into effect and the balance net of the associated accumulated deferred federal and state income tax balance should accrue a monthly carrying charge utilizing the company's AFUDC rate.

Q. Have you adjusted the accumulated deferred taxes related to Staff changes in book depreciation expense and revised plant additions?

A. Yes. The Panel has reflected the revised book depreciation expense and tax depreciation expense associated with Staff adjustments within the Federal Income Tax and State Income Tax calculations. The accumulated deferred Federal Income Tax expense and State Income Tax expenses was increased by $1,678,000 (Adjustment 29) and reflected as a reduction to rate base.

Q. Have you adjusted the cash working capital allowance included in rate base?

A. Yes. The company's calculation of the rate year cash working capital allowance utilizes the total operation and maintenance expenses less fuel costs and the uncollectible loss allowance. However, the rate year estimated operation and maintenance expense includes $12,125,000 of pension and $13,812,000 of OPEB's expenses. Both the pension and OPEB's expenses are considered to be non-cash items and should be excluded from operation and maintenance expenses before computing the cash working capital allowance. The exclusion of these non-cash expenses in addition to reflecting the Staff adjustments to these items reduces the total cash working capital allowance by $4,121,000 from $20,899,000 to $16,778,000.

Q. Have you adjusted the company's Earnings Base/Capitalization adjustment included in rate base?

A. Yes. The company has performed an Earnings Base/Capitalization measurement for the historic test year in this rate case. Within the calculation, the company failed to exclude the twelve-month average balance of inter-company Accounts Payable and Accounts Receivable balances associated with fuel costs. The company, within this rate proceeding, is requesting a cash working capital allowance for gas costs as a carrying charge collected through the GAC/TAC/Surcharges. The Company's inclusion of average inter-company Accounts Payable and Accounts Receivable balance associated with fuel costs within its capitalization is in effect a double count. Our proposal is to remove the average inter-company accounts payable and accounts receivable balances from capitalization. This revision decreases the Earnings Base/Capitalization adjustment by $8,891,000 (Adjustment 32) which increases the company's rate year rate base.

Q. Have you adjusted the cash working capital allowance included in the Historic Test year earnings base?

A. Yes. The Company's calculation of the Historic Test Year cash working capital allowance includes the estimate Pension expense of $2,323,000,000 and OPEB's expense of $4,654,000,000 included within the estimated operations and maintenance expense. Both the Pension and OPEB's expense are considered to be non-cash items and should be excluded from operation and maintenance expense before computing the cash working capital allowance. The exclusion of these non-cash items will reduce the total historic test year cash working capital allowance by ($872,000) (Adjustment 35).

Q. Does this conclude your testimony in this case?

A. Yes, at this time.