

DIRECT TESTIMONY  
OF  
LARRY G. ARVIDSON

1 Q. Please state your name and business address.

2 A. My name is Larry G. Arvidson and my business address is Central Hudson  
3 Gas & Electric Corporation ("Central Hudson" or the "Company") 284 South  
4 Avenue, Poughkeepsie, New York 12601-4879.

5

6 Q. Who is your employer and what do you do?

7 A. Central Hudson Gas & Electric Corporation employs me as a Cost of Service  
8 Specialist in the Cost & Rate Division.

9

10 Q. Please summarize your education and experience.

11 A. I received a B.S. degree in Zoology from the University of Nebraska in 1969.  
12 I subsequently did graduate work at Northeastern University and Clark  
13 University while employed at the Worcester Foundation for Experimental  
14 Biology from 1969 to 1971. From 1971 to 1973 I did graduate work at the  
15 University of Connecticut while employed by the National Marine Fisheries  
16 Service. I began my association with Central Hudson in late 1973 by  
17 accepting a research position with Lawler, Matusky and Skelly Engineers  
18 who had contracted with the Company to study the ecology of the Hudson  
19 River. In 1980, Central Hudson's Environmental Affairs Division employed  
20 me as an Environmental Specialist. I was promoted to Hazardous Waste  
21 Coordinator in November of 1987 and transferred in January 1989 to the  
22 Cost & Rate Division. I have since received training in utility finances at  
23 Indiana University's Graduate School of Business and the Financial

1 Accounting Institute.

2

3 Q. Have you previously testified before this Commission?

4 A. Yes. I testified on the subject of cost of service related to the Company's gas  
5 operations in Cases 90-G-0673, 92-G-1056, 95-G-1034, 00-G-1274 and 05-  
6 G-0935; and on the subject of cost of service related to the Company's  
7 electric operations in Cases 91-E-0506, 92-E-1055, 00-E-1273 and 05-E-  
8 0934.

9

10 Q. What is the purpose of your testimony in this proceeding?

11 A. My testimony presents Cost of Service (COS) information regarding the  
12 Company's gas operations and electric operations. I have prepared four  
13 separate embedded COS studies (fully allocated and unbundled per C.00-M-  
14 0504 Unbundling Track guidelines): a historical study and a pro forma study  
15 of gas operations; and, a historical study and a pro forma study of electric  
16 operations. The two historical studies pertain to the calendar year ended  
17 December 31, 2006. The pro forma studies pertain to the Rate Year of the  
18 twelve months ending June 30, 2010.

19

20 Q. What is the purpose of an embedded cost of service study?

21 A. The basic purpose is to determine the earned rate of return (ROR) on rate  
22 base by service class in order to evaluate the relationship between current  
23 rates being charged each customer class and the costs incurred to serve

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1 each customer class. Basically, revenues less expenses divided by rate  
2 base yields the ROR, an estimate of net income received for each dollar  
3 invested to provide service.

4

5 Q. What is the difference between an embedded, historical COS and a pro  
6 forma COS?

7 A. A pro forma study uses rate year forecasts for system loads, revenues,  
8 expenses, and rate base to develop an estimated ROR by service class.

9 The historical COS uses data as recorded on the Company's books for a  
10 particular calendar year, in this case, 2006. The historical and pro forma  
11 studies together allow comparison of REALIZED to EXPECTED rates of  
12 return given the rate structure in effect **July 2008**.

13

14 Q. How many service classes and subclasses do your studies involve?

15 A. The electric department COS studies address twelve subclasses: SC1-  
16 residential general/non-heating, SC1-residential heating, SC6-residential  
17 time-of-use, SC2-small general service non-demand metered, SC2-small  
18 general service secondary demand metered, SC2-small general service  
19 primary demand metered, SC3-large general primary, SC13-large general  
20 substation, SC13-large general transmission, SC5-area lighting, SC8-street  
21 lighting and SC9-traffic signals.

22 The gas department COS studies address nine subclasses: SC1-residential  
23 heating, SC1-residential non-heating, SC2-commercial/industrial heating,

1 SC2-commercial/industrial non-heating, SC8 & 9-interruptible, WP-West  
2 Point, Interdepartmental (Central Hudson's own use of gas), SC11t-firm  
3 transportation and SC11d-firm distribution.

4

5 Q. Have you prepared any exhibits to support your testimony?

6 A. Yes. I have prepared Exhibits (LGA-1) and (LGA-2) which comprise the  
7 following schedules:

8

9 Exhibit (LGA-1)-Gas Department Embedded Study:

10 Schedule A - Gas Department Rate of Return Statement for the Historical  
11 Year 2006;

12 Schedule B - Gas Department Rate of Return Statement for the Pro Forma  
13 Rate Year 7/2009-6/2010;

14 Schedule C - Gas Department Levelized Revenue Requirement for the Pro  
15 Forma Rate Year 7/2009-6/2010 with a targeted ROR to illustrate a potential  
16 rate structure with unbundled components.

17

18 Exhibit (LGA-2)-Electric Department Embedded Study:

19 Schedule A - Electric Department Rate of Return Statement for the Historical  
20 Year 2006;

21 Schedule B - Electric Department Rate of Return Statement for the Pro  
22 Forma Rate Year 7/2009-6/2010;

23 Schedule C - Electric Department Levelized Revenue Requirement for the

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1 Pro Forma Rate Year 7/2009-6/2010 with a targeted ROR to illustrate a potential  
2 rate structure with unbundled components.

3

4 Q. Please outline the methods used to prepare an embedded cost of service.

5 A. The basic procedure is to allocate rate base, expenses, and revenue among  
6 the various service classes via a three step process of (1) functionalization  
7 and (2) classification of investment and expenses; then, (3) allocation of  
8 those "costs" among the service subclasses.

9

10 Q. Please explain what is meant by the term "functionalization".

11 A. Functionalization characterizes the analysis and re-grouping of the various  
12 plant investment and expenses according to the activity or "function" for  
13 which the cost was incurred rather than by the FERC/PSC account number  
14 to which it was booked. The conventional "functions" are Production-related,  
15 Transmission-related, Distribution-related or Customer-related.

16

17 Q. How did you determine the function of a cost?

18 A. Company accounting records and data maintained for engineering purposes  
19 are the principal sources of information used in the functionalization process.  
20 Personnel from the Company's accounting and engineering areas also  
21 provided assistance in identifying the particular function or functions of  
22 specific investments.

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1

2 Q. Would you please provide an example of a functionalized cost?

3 A. Costs recorded in the Electric Plant Account 353, Transmission Station  
4 Equipment, averaged about \$83 million in 2006. Records as to the type and  
5 location of the equipment represented by this investment indicate that about  
6 \$1.4 million served a production function; \$69.5 million served a power  
7 supply transmission function; \$12.2 million - a distribution function and about  
8 \$100,000 served a specific class of customers.

9

10 Q. Please explain what is meant by the term "classification".

11 A. Classification refers to the process of separating the functionalized costs into  
12 amounts related to Demand, Energy or Number of Customers. Demand-  
13 related costs vary in proportion to the rate (in kW or Mcf) at which customers  
14 require a commodity. Energy-related costs vary in proportion to the total  
15 volume of the commodity delivered. Customer-related costs vary in  
16 proportion to the number of customers served. A smaller, fourth category of  
17 costs, Specific, defines costs that can be attributed to a particular service  
18 class of customers.

19

20 Q. Regarding your reference to the functionalization of Electric Account 353,  
21 how did you classify these costs?

22 A. Since virtually all of the equipment booked to Account 353 must be sized to

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1 meet the expected maximum collective demand of all customers, the non-  
2 specific functional categories were classified as demand-related investment.  
3 The remainder, about \$100,000, was directly functionalized to allow  
4 allocation to a specific class.

5

6 Q. Please explain what is meant by the term "allocation".

7 A. Allocation refers to the process of distributing the functionalized and  
8 classified costs among the service classes on the basis of service class  
9 contribution to peak<sup>1</sup> demand (in kW); or, class contribution to total volume of  
10 commodity delivered (i.e. Energy in MWh); or, class contribution to total  
11 number of customers (sometimes weighted); or, by direct assignment to a  
12 specific rate class when appropriate.

13

14 Q. Continuing with your Account 353 example, how was the plant investment  
15 ultimately allocated?

16 A. Investment functionalized as "power supply transmission" was allocated to  
17 the various service classes on the basis of their respective contribution to the  
18 average of the summer and winter coincident peak demands. Investment

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<sup>1</sup> Several types of 'demand' allocators are used: Summer/Winter Coincident Peak (CP) demand, Class NCP (non-coincident peak kW); Sigma NCPi (sum of individual customer's peak demand).

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1 functionalized as "distribution-related" was allocated per class contribution to  
2 the class non-coincident peak demand (corrected for losses) at the  
3 substation level of service. Investments functionalized as "specific" were  
4 directly allocated to the rate classes of customers to be served by that  
5 investment.

6

7 Q. What major sources of information were used to develop the historical cost of  
8 service studies?

9 A. The "Electric Utility Cost Allocation Manual" dated January 1992 by the  
10 National Association of Regulatory Utility Commissioners was used as the  
11 basic reference on cost of service methodology. Company accounting and  
12 engineering records yielded additional information for the functionalization  
13 and classification of various costs. The Company's Annual Report to the  
14 State of New York Public Service Commission for the year ended December  
15 31, 2006 was the principal source for Income Statement items and Operation  
16 & Maintenance expenses. The Company developed demand allocators from  
17 a comprehensive load research program. Company billing records yielded  
18 number of customers, kWh/Mcf sold/delivered and revenues by rate code  
19 and service class.

20

21 Q. What major sources of information were used to develop the rate year pro  
22 forma cost of service studies?

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1 A. The Company's Financial Planning department provided rate year income  
2 statements for both gas & electric, which included estimates for future Rate  
3 Base, O&M, Depreciation and Amortization and other operating expenses.  
4 Colleagues in Cost & Rate provided revenue, sales and customer forecasts.  
5 Details regarding future plant investments, depreciation reserve and taxes  
6 came from the Accounting department. Rate year demand allocators were  
7 developed via the relationship of historical kWh/customer/class to historical  
8 kW/customer/class vs. forecast kWh/customer/class. Data for the forecasted  
9 rate year is entered into the COS spreadsheets to derive an expected ROR  
10 on rate base by customer class, given currently effective rates. A  
11 comparison of class ROR to the system average ROR will indicate which  
12 rates need to be adjusted: to improve the system average ROR and/or  
13 reduce interclass subsidies.

14

15 Q. What are the main differences between the 2006 embedded COS studies  
16 and the rate year studies?

17 A. The historical studies include rate base, revenues and expenses associated  
18 with commodity purchases of electricity and gas as well as delivery service  
19 rate base, revenues, and expenses. In contrast, the rate year studies  
20 contain neither fuel-related expenses nor expenses for the purchase of  
21 electric or gas commodities.

22

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1 Q. What is the usefulness of the historical year COS studies?

2 A. To document actual realized rate base, revenues and expenses by rate class  
3 that is reconcilable to Central Hudson's Annual Report to the PSC; and, to  
4 facilitate unbundling by reference to actual calendar year labor and expenses  
5 by PSC account and CHG&E function number.

6

7 Q. What is the primary purpose of the rate year COS studies?

8 A. To provide a frame of reference for the rate department to design delivery  
9 service rates that produce relative ROR uniformity among the various rate  
10 classes and a fair rate of return on the Company's investments: in short,  
11 cost-based rates.

12

13 Q. What are delivery service rates; and, how do they differ from full service  
14 rates?

15 A. Delivery service rates are intended to provide a fair return on the Company's  
16 investment associated with moving electricity or gas from a source to the  
17 customer (e.g. a return on wires & pipes). A delivery service rate excludes  
18 all costs associated with the commodity; full service rates include the  
19 commodity cost.

20

21 Q. How did you classify production plant in the Electric COS studies?

22 A. Consistent with the decision in C. 00-E-1273, hydroelectric production plant

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1 was classified energy-related; combustion turbines were classified demand-  
2 related.

3

4 Q. How did you classify production plant in the Gas COS studies?

5 A. As in Cases 90-G-0673, 92-G-1056, 95-G-1034, 00-G-1274 and 05-G-0935,  
6 gas production plant was classified 100% demand-related since the  
7 Company's gas production investment is in propane peaking facilities built to  
8 meet anticipated winter peak demand.

9

10 Q. You made reference to unbundled functions and C.00-M-0540 earlier in your  
11 testimony. Could you please elaborate?

12 A. The Unbundling Track of Case 00-M-0504 required Central Hudson to file  
13 fully allocated embedded COS studies with unbundled rates based on those  
14 studies in their next rate case. In compliance, the Company filed such  
15 studies in Cases 05-E-0934 & 05-G-0935, which led to the development of  
16 the unbundled Merchant Function Charges (MFCs) that currently appear on  
17 full-service customer's bills.

18

19 Q. Have you filed fully unbundled COS studies in the instant Case?

20 A. Yes. The electric and gas embedded COS studies prepared for this rate  
21 case identify the revenue requirements for bundled and unbundled  
22 components. Cost-based potential MFCs for customer's taking commodity

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1 service from an ESCO have been updated and are shown in Exhibit\_\_(LGA-  
2 1) Schedule C for gas customers and Exhibit\_\_(LGA-2) Schedule C for  
3 electric customers.

4

5 Q. How many cost components have you unbundled?

6 A. Four for the gas department and seven for the electric department.

7

8 Q. Could you please identify each of the unbundled components and explain the  
9 different number of unbundled functions for gas and electric?

10 A. The unbundled components common to both electric & gas departments  
11 include: procurement; credit & collections; bill printing, mailing and receipt  
12 services (BPRS); and, competitive energy services (CES). The unbundled  
13 components unique to the electric department include: meter ownership;  
14 meter services; and meter data services. The State of New York Public  
15 Service Commission has not yet mandated competitive metering for gas  
16 customers.

17

18 Q. Could you please identify the kinds of costs that are included in each of the  
19 unbundled component's revenue requirements?

20 A. **Procurement** includes shares of common plant, labor & expenses<sup>2</sup> related  
21 to the acquisition of commodity for Central Hudson customers, allocated

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1 shares of call center costs and allocated shares of PSC accounts 905, 908  
2 and Administrative & General O&M accounts 920 through 932 proportionate  
3 to full service credit & collections expenses. The **Credit & Collections** (for  
4 delivery service) revenue requirement includes a share of account 904  
5 (Uncollectible Accounts) proportionate to bad debt on delivery service as well  
6 as allocated shares of call center, credit and collections, bill complaints, and  
7 shares of 905, 908 & 920 through 932 proportionate to labor & expenses  
8 concerning delivery service credit & collections. The **BPRS** (bill printing,  
9 mailing and receipt services) revenue requirements and unbundled costs  
10 include labor and expenses attributable to the cash processing department,  
11 the annual charges of Regulus (the company currently contracted by CHG&E  
12 to print and mail bills) plus allocated shares of call center costs and shares of  
13 expenses booked to PSC accounts 905, 908 & 920 through 932.

14 **Competitive Energy Services (CES)** includes the labor and expenses of  
15 our marketing department and advertising expenses related to sales  
16 promotions, plus an allocated share of call center costs and shares of  
17 expenses booked to PSC accounts 905, 908 & 920 through 932.

18  
19 Regarding the unbundled components unique to the electric department:  
20 meter ownership – reflects the service class average meter cost and average  
21 initial installation costs for non-demand meters but only the class average

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2 Including credit & collections costs related to the commodity.

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1 meter cost for demand metered customers; meter services – reflects the  
2 class average avoidable maintenance expense per meter; and, meter data  
3 services – reflects the class average meter reading cost.

4

5 Q. Please briefly describe the methods used to assign labor and expenses to  
6 each of the unbundled functions.

7 A. The analysis began with the compilation of year 2006 labor expenses (by  
8 area and function number) as recorded in each PSC account greater than or  
9 equal to 900.00; roughly 300 function numbers in the electric department and  
10 200 in the gas department. Most areas within CHG&E use 900 series  
11 accounts only for overhead-type functions (e.g., general office salaries);  
12 consequently, these labor expenses were temporarily functionalized as  
13 PTDC-related for later functionalization on labor sub-total across all  
14 functions. Several areas, however, use 900 series accounts to record  
15 virtually all expenses. Labor and expenses in each of these areas were  
16 examined in detail and unbundled as appropriate.

17

18 Briefly, all labor and expenses booked to account 902, meter reading, were  
19 unbundled for the electric department but left bundled with customer  
20 accounts expenses for the gas department. Expenses booked to PSC  
21 account 904, Uncollectibles, were split proportionately between commodity-  
22 related bad debt and delivery service-related bad debt. Expenses booked to

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1 PSC account 903 by the call center were allocated to the various bundled &  
2 unbundled functions per surveys of call types from customers. Credit &  
3 collections costs booked to 903 were split like uncollectibles: to commodity-  
4 related procurement vs. delivery-service-related expenses. With the  
5 exception of Regulus costs, most labor and expenses booked to PSC  
6 account 905 were functionalized per the unbundled subtotal of 902 & 903  
7 labor. As previously mentioned, Regulus charges for printing and mailing  
8 bills to customers were unbundled to the BPRS function together with all  
9 labor & expenses from our cash processing department (from accts 903,  
10 905, 908 and some A&G accounts). Marketing labor & expenses (within 908  
11 & 912) were unbundled to CES together with advertising related to sales  
12 promotions (within PSC account 916) and shares of call center costs from  
13 several accounts.

14

15 Q. Should the unbundled costs and MFCs that you have described and shown  
16 in Schedule C of (LGA-1) & (LGA-2) be available to all customers?

17 A. It is my opinion that the complete array of unbundled costs should only be  
18 avoided by current full-service customers who subsequently contract with an  
19 ESCO for commodity service, choose to have a single bill issued by the  
20 ESCO (an ESCO that agrees to assume all credit and collections costs); and,  
21 if an electric customer, contracts with a METERCO for all metering services.

22

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1 Q. Why shouldn't current Retail Access/Delivery Service gas customers be  
2 eligible to avoid the full range of unbundled components?

3 A. They would be if they chose to have a single bill issued by the ESCO; and,  
4 their ESCO assumed all uncollectibles, credit and collections responsibilities.

5 Currently, we have no retail access customers who have chosen to have a  
6 single bill issued by the ESCO<sup>3</sup>. We do have customers who have chosen a  
7 single bill issued by CHG&E and they receive a BPRS credit but the ESCO  
8 reimburses us for that cost. A similar arrangement might be used to make  
9 the Company whole regarding other credits: all retail access customers  
10 would "see" the full range of unbundled costs credited to bills; but, unless the  
11 ESCO assumed all uncollectibles, credit and collections responsibilities, the  
12 ESCO would reimburse CHG&E for the amounts credited to the customer;  
13 or, some other method of lost revenue recovery was available to the  
14 Company.

15

16 Q. Please briefly describe the results of the Gas Department COS studies.

17 A. Schedule A (the historical study) and Schedule B (the pro forma study)  
18 summarize the rates of return for the system and for service subclasses.

19 Line 9 on each of the schedules details Rate Base by service class; Line 12  
20 shows Total Operating Revenues; Line 18 shows Total Operating Expenses;

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3 Partly because our current billing system is unable to handle ESCO rate-ready components

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1 Line 19 shows Operating Income (line 12 less line 18); and, Line 20 shows  
2 Rates of Return (line 19 divided by line 9).

3 The Index of Return, Line 21, indicates the relative degree of difference  
4 between the system total ROR and the ROR of each service class (100  
5 signifies a ROR equal to the System ROR; 85 and 115 respectively indicate  
6 a ROR 15% less than and 15% greater than the System ROR).

7

8 The results from the historical Gas COS study show the system average  
9 ROR below that 'allowed' for rate year 1, 2 or 3 under the Order Establishing  
10 Rate Plan<sup>4</sup> in Case 05-G-0935 Issued and Effective July 24, 2006. Further,  
11 the 2006 ROR statement shows the rates of return from three of the seven  
12 rate classes to be below the system average ROR.

13 The results shown in (LGA-1) Schedule B, the pro forma rate year gas COS  
14 study reveal a system average ROR at 3.16%, below the allowed 7.13%,  
15 with three of seven classes also below the system average ROR.

16

17 Exhibit\_\_(LGA-1) Schedule C Page 1 of 2 shows the approximate gas  
18 department revenue requirements by function to achieve a system average  
19 ROR of 7.81%, from each customer class. Exhibit\_\_(LGA-1) Schedule C  
20 Page 2 develops (from Page 1) bundled delivery service rates (lines 53, 54 &  
21 55) for each service class and potential back-out credits for each of the

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1 unbundled components (lines 56-59). Finally, lines 60-63 develop delivery  
2 service rates with unbundled Merchant Function Charges (MFCs) for  
3 Administration (MFC<sub>A</sub>) and Supply (MFC<sub>B</sub>) for each rate class of customer.

4

5 Q. What customers might be eligible for MFC<sub>A</sub> and MFC<sub>B</sub>?

6 A. Any Retail Access customer of an ESCO that provided a single bill and  
7 assumed all credit and collection responsibilities would be eligible to avoid  
8 both MFC<sub>A</sub> and MFC<sub>B</sub>. A gas customer electing Retail Access service, with  
9 dual billing or single billing from CHG&E, would be eligible to avoid only the  
10 Supply Charge, MFC<sub>B</sub> (the Procurement and CES unbundled components;  
11 re: line 62).

12

13 Q. Please briefly describe the results of the Electric Department embedded  
14 COS (ECOS) studies.

15 A. Exhibit\_\_(LGA-2) Schedule A (the historical year electric study) and  
16 Exhibit\_\_(LGA-2) Schedule B (the pro forma RY#1 electric study) similarly  
17 summarize the rates of return for the electric system and show the allocation  
18 of Rate Base, Revenues, Operating Expenses and resultant ROR by each  
19 customer rate classification.

20 Again, the Index of Return indicates the relative degree of difference  
21 between the system total ROR and the ROR of each service class (100

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4 re: Appendix H, Schedule 1, Weighted cost 7.05, 7.09 & 7.13 for RY1,2,3

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1 signifies a ROR equal to the System ROR; 85 and 115 respectively indicate  
2 a ROR 15% less than and 15% greater than the System ROR).

3 The results from the 2006 electric department COS study reveal indexes  
4 below 85 for the SC5 & SC9 lighting classes, SC1-Non-heat, SC2-non-  
5 demand and SC13 Large General Transmission rate classes. All other  
6 classes had RORs above the 2006 system average ROR.

7  
8 Exhibit\_\_(LGA-2) Schedule B details the Pro Forma Rate Year #1 Delivery  
9 Service forecasted costs and expected revenues as allocated by the  
10 embedded electric cost of service study to the rate classes; and, the  
11 estimated Rates of Return by class (under the July 2008 rate structure, with  
12 rate base moderation<sup>5</sup>). Schedule B shows the SC2 non-demand, SC13  
13 substation, SC13 transmission and the SC5 lighting classes to be below a  
14 system index of 85 with all other classes above an index of 85.

15  
16 Exhibit\_\_(LGA-2) Schedule C shows the revenue required to produce a  
17 targeted system average ROR of 7.81% from each service class (i.e.  
18 “levelized” revenue requirements), together with a potential rate structure for  
19 delivery service with backout credits for each of the unbundled components.

20 The levelized bundled rates are shown in lines 60 through 62 and the

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5 re: Exhibit\_\_(RRP-1), Schedule B, fifth column of numbers.

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1 unbundled backout credits potentially available to any retail access electric  
2 customer shown in lines 63 through 69.

3

4 Q. What might be the minimum Merchant Function Charge that a retail access  
5 electric customer might avoid?

6 A. An electric customer choosing an ESCO for commodity service with a 2 bill  
7 option or a single bill from CHG&E would be eligible for  $MFC_B$  (reflecting the  
8 procurement credit shown on line 63 and the CES credit shown on line 69).  
9 The combined backout expressed in  $\$/kWh$  is shown in line 73.

10

11 Q. What might be the maximum delivery MFC that a retail access electric  
12 customer could avoid?

13 A. An electric customer choosing an ESCO for commodity service that issued a  
14 single bill and assumed all credit and collections responsibilities for delivery  
15 service would be eligible to avoid both the Supply and the Administrative  
16 Merchant Function Charges (respectively  $MFC_B$  and  $MFC_A$  shown in  
17 Schedule C, page 2, lines 73 and 74).

18

19 Q. Does this conclude your pre-filed direct testimony?

20 A. Yes.