

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-51

Request:

Please provide a schedule showing each exogenous event that occurred under the 2000 Settlement, the amount and its effect in the base distribution rates for each year.

Response:

The only event to occur that qualified as an exogenous event under the Current Settlement was the enactment of Bonus Tax Depreciation rules. Please refer to the response to Commission Data Request 1-9 for the calculation of the impact of Bonus Tax Depreciation on Narragansett's 2004 revenue requirement, the first year this additional tax benefit exceeded the exogenous event threshold as established in the Current Settlement.

Prepared by or under the supervision of: Michael D. Laflamme

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-52

Request:

Please provide examples of each type of exogenous event listed in Part 2(B) of the Proposed Settlement.

Response:

The Exogenous Events, together with typical examples, which will depend on actual events over the period of the Settlement, are listed below:

(1) State Initiated Cost Change. The most common example of a state initiated cost change is an increase or decrease in the tax rate. Other examples could include the renewable portfolio standards that have recently been enacted and will become effective over the Fixed Rate Period.

(2) Federally Initiated Cost Change. This category includes federal income tax rate changes. Modifications to regulatory requirements by FERC or other agencies could also trigger an exogenous event. An example could be a new FERC rule that allows the by-pass of local distribution tariffs and charges, or imposes new obligations relative to the interconnection of new third-party generation facilities.

(3) Regulatory Cost Reallocation. This category includes a shift in jurisdiction between FERC and the states, for example by shifting the boundary between transmission and distribution functions, or by shifting cost responsibility between the generation or supply function and the distribution or delivery function. In the case of regulatory cost allocations, one would expect that the change in costs to the distribution function would be offset by changes in costs to the transmission and supply functions. However, that is not always the case.

(4) Excessive Inflation. Excessive inflation is determined by the formula that is set forth in the Settlement. Under that provision, Narragansett accepts the risk of inflation through December 31, 2007.

Prepared by or under the supervision of: Legal Department

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-53

Request:

Please explain the rationale for the methodology of any adjustments made due to exogenous events as explained in Part 2(C)(1) of the Settlement on page 6.

Response:

Section 2(C)(1) sets forth the timing of the filing for exogenous factors, the allocation of the costs, and the design of the factors. The costs or savings associated with exogenous events are proposed to be allocated 50 percent based on kilowatt-hour deliveries and 50 percent based on distribution service revenues allocated to the class, both related to the year during which the exogenous event amounts were accrued. This allocation matches the agreed upon allocation and ultimate rate design of the other components of the Settlement, specifically the Customer Credit and the base distribution rate reduction. The rationale for this allocation is explained in the response to Commission Data Request 1-23. First, it represents a reasonable compromise among the Parties. Second, it reflects the fact that exogenous events affect the underlying cost to Narragansett of providing the service, and it is reasonable to allocate the exogenous event cost or savings in the same manner as the proposed rate reduction implemented in this Settlement.

Prepared by or under the supervision of: Carlos A. Gabilondo

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-54

Request:

Please explain the rationale for allowing the Company to accrue interest when there is a cost because of an exogenous event, but there is no like provision for the Company to pay interest when there is a refund due to ratepayers because of an exogenous event.

Response:

The provision affecting interest is a continuation of that contained in the Current Settlement. It provides interest at the customer deposit rate to the Company when the accumulated cost associated with an exogenous event exceeds \$1.0 million or in the event that the implementation of an increase to recover the cost is delayed beyond April 1, the date contemplated in the Settlement for implementation of an exogenous factor. Under the Settlement, any customer credit related to an exogenous event that occurs in a calendar year is to be credited to customers beginning April 1 of the immediately following year. There is no provision for the delay of such credit. As a result, even if interest were to apply to an exogenous factor credit amount, the period of time from the occurrence of the exogenous event to implementation of the refund credit would likely not produce any significant interest. On the other hand, the Settlement expressly contemplates that an exogenous event that would result in a surcharge could be delayed, and that cost recovery might not commence on April 1 of the year following the exogenous event as would be the case for a credit. Given the asymmetric risk presented by the potential delay of exogenous event recovery, and the real potential that such delay might occur, the interest for exogenous events as set forth in the Settlement is reasonable.

Prepared by or under the supervision of: Carlos A. Gavilondo

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-55

Request:

Does the language, 'If and when the Company makes a filing seeking an adjustment that increases rates under this section, if the average intrastate return on equity of the Company exceeds 10.5%, the Company will not be permitted to make a rate adjustment until the average return has dropped below 10.5%' refer to every provision of Part 2(B) and (C) or just Part 2(C)?

Response:

It refers to every provision of Part 2(B).

Prepared by or under the supervision of: Robert H. McLaren

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-56

Request:

How is having a low income rate a benefit to all ratepayers?

Response:

The availability of a low income rate is consistent with the clear public policy of the State. *See, e.g.,* R.I. G.L. § 39-1-1(d)(7) (requiring the continuation of low income customer protections after restructuring). In addition, to the extent electric service is more affordable for low income customers, there is a greater opportunity for these customers to remain current on their payments for the service. This would reduce the cost of collection activities and bad debt expense for all customers.

Prepared by or under the supervision of: Carlos A. Gabilondo

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-57

Request:

If the eligibility for the low income rate was limited to the eligibility requirements in place on August 8, 1996, how many customers would be eligible and what would be the annual cost to ratepayers and to the Company?

Response:

Prior to the expansion of the low income rate pursuant to the Current Settlement, eligibility for Rate A-60 was limited to customers who were a) the head of household and b) receiving Supplemental Security Income from the Social Security Administration, or assistance from one of the following Rhode Island agencies: Medicaid, Food Stamps, General Public Assistance or Aid to Families with Dependent Children. In the Current Settlement, the program was expanded to include those customers eligible for assistance through the state's LIHEAP program. Absent the expansion, approximately 10,800 customers of the total Rate A-60 class of approximately 32,400 customers would receive service under Rate A-60. The low income subsidy for this group of customers would be approximately \$1.2 million annually based on actual billing units for 2003 as compared to the low income subsidy provided to all low income customers of approximately \$3.6 million annually. The attached schedule provides the detail of this estimate.

Prepared by or under the supervision of: Jeanne A. Lloyd

The Narragansett Electric Company
 Commission Data Request 1-57
Calculation of Annual Low Income Subsidy for LIHEAP and non-LIHEAP Customers

Billing Units for non-LIHEAP and Total Rate A-60 Customers (1)

	<u>non-LIHEAP</u>	<u>Total Class</u>
Number of Bills - A60	124,247	366,699
kWhs - A60	66,072,438	181,496,965
Number of Bills - A62 (Water Heating)	1,504	14,535
kWhs - A-62 (Water Heating)	3,199,480	12,230,498

(1) Based on actual 2003 billing data

Estimated Subsidy - non-LIHEAP Customers

<u>Rate A-60 Revenues</u>	<u>Units</u>	<u>Charges</u>	<u>Revenues</u>	
Customer Charge	124,247	\$0.00	\$0	
kWh Charge	66,072,438	\$0.02324	\$1,535,523	
Revenue on Rate A-60				\$1,535,523
<u>Rate A-16 Revenues</u>	<u>Units</u>	<u>Charges</u>	<u>Revenues</u>	
Rate A16 Customer Charge	124,247	\$2.54	\$315,587	
Rate A16 kWh Charge	66,072,438	\$0.03642	\$2,406,358	
Revenue on A16				<u>\$2,721,946</u>
		Subsidy (non-LIHEAP Customers).....		\$1,186,422
<u>Rate A-62 Revenues</u>	<u>Units</u>	<u>Charges</u>	<u>Revenues</u>	
Customer Charge	1,504	\$0.00	\$0	
kWh Charge	3,199,480	\$0.02324	\$74,356	
Revenue on Rate A-62				\$74,356
<u>Rate A-18 Revenues</u>	<u>Units</u>	<u>Charges</u>	<u>Revenues</u>	
Rate A18 Customer Charge	1,504	\$2.52	\$3,790	
Rate A18 kWh Charge	3,199,480	\$0.03536	\$113,134	
Revenue on A18				<u>\$116,924</u>
		Subsidy (non-LIHEAP Customers).....		\$42,568
		Total Subsidy (non-LIHEAP Customers)		\$1,228,990

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-58

Request:

Exhibit 8, page 2 of 11 of the Settlement Agreement indicates that the Company will recover 25% (\$1,320,000) of the net low income subsidy. What party will absorb / be charged for the remaining 75% (\$3,960,109)?

Response:

Section 20 of the Current Settlement authorizes the Company to recover the incremental low income expansion costs over \$600,000 per year (adjusted to \$640,000 pursuant to section 4(d) of the Current Settlement as described in the response in Commission Data Request 1-60) from all customers through a fully reconciling uniform per kWh adjustment factor. Because of the 75 percent earnings sharing that is expected to occur during the initial rate freeze period under the Current Settlement, the Company reflected only 25% (\$1,320,000) of the estimated incremental expansion costs expected to be incurred through 2004 as a direct charge to the customer share of the earned savings. Thus, rather than recover 100 percent of the incremental expansion costs from customers and then return 75 percent of this recovery to customers through the earnings sharing mechanism, the Company included 25 percent of the incremental expansion costs directly as a reduction to the Customer Shared Earnings, producing the same net recovery from customers.

Prepared by or under the supervision of: Michael D. Laflamme

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-59

Request:

Which party or parties will absorb / be charged for the low income subsidy incurred in 2005 and beyond? How will it impact earning sharing calculations?

Response:

The Company's proposed distribution charges assume an estimated level of low income subsidy of approximately \$3.5 million.¹ Of this amount, approximately \$2.3 million represents the incremental amount associated with the expansion of the low income rate. Although under the Current Settlement, the Company is authorized to increase rates by this amount, as part of the Settlement it has waived that right in the proposed Settlement. Therefore, the Company and its customers are sharing in the subsidy provided to this group of customers through the proposed distribution charges. Any increase in the number of customers served on Rate A-60 and in the subsidy provided to that rate class will further reduce the Company's revenue during the rate freeze period which will be reflected as a reduction to net income, and will therefore be reflected in the Company's earnings and the earnings sharing mechanism.

Prepared by or under the supervision of: Jeanne A. Lloyd

¹ See Exhibit 5, page 7.

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-60

Request:

Exhibit 8, page 2 of 11 of the Settlement Agreement indicates that the Company share of the expansion costs during the rate freeze period ending 12/31/04 is \$640,000 annually. Paragraph 20 of the Third Amended Stipulation and Settlement indicates an annual Company share of \$600,000. Please reconcile the difference.

Response:

Section 4 of the Current Settlement specified a formula for the calculation of monthly credits provided by the Company to customers for the delayed implementation of consolidated rates. The credits were to be applied by reducing the deferred tax deficiency of Blackstone Valley Electric Company and Newport Electric Corporation that would otherwise exist following the merger. Pursuant to Section 4(d), for every \$500,000 of credits applied under Section 4, the Company's contribution to the incremental cost of the low income expansion was to increase by \$40,000. In April 2000, Blackstone recorded a credit of approximately \$312,000 (\$500,000 net of taxes) due to a one month delay in the rate consolidation date, and accordingly, the low income expansion costs to be borne by the Company increased to \$640,000.

Prepared by or under the supervision of: Michael D. Laflamme

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-61

Request:

Utilizing the rate design proposed in the settlement, please provide an estimate of the A-60 subsidy for each year 2005-2009?

Response:

Based on the normalized rate year billing determinants as shown on Exhibit 5, page 7 of 26, and assuming no growth in the number of customers taking service on Rate A-60 or their aggregate load, the estimated subsidy for each year based on the proposed rates for Rates A-16 and A-60 would be as follows:

2005	\$3,462,558
2006	\$3,461,139
2007	\$3,459,720
2008	\$3,458,301
2009	\$3,456,882

The attached spreadsheet provides the detailed calculation of the estimated annual subsidy.

Prepared by or under the supervision of: Jeanne A. Lloyd

The Narragansett Electric Company
 Commission Data Request 1-61
Calculation of Annual Low Income Subsidy for 2005 through 2009

Rate A-60 Billing Determinants - Normalized Rate Year 2005

	<u>Total Class</u>
Number of Bills	385,005
First 500 kWh (1)	141,900,465
kWhs in excess of 500	<u>50,179,535</u>
Total kWhs	192,080,000

(1) Based on Test Year billing data

Estimated Annual Subsidy

Year		<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
<u>Proposed Rate A-60 Charges</u>	<u>Units</u>	<u>Charges</u>	<u>Charges</u>	<u>Charges</u>	<u>Charges</u>	<u>Charges</u>
Customer Charge	385,005	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Initial Block Charge	141,900,465	\$0.01690	\$0.01690	\$0.01690	\$0.01690	\$0.01690
Tail Block Charge	50,179,535	\$0.03384	\$0.03383	\$0.03382	\$0.03381	\$0.03380

<u>Proposed Rate A-16 Charges</u>	<u>Units</u>	<u>Charges</u>	<u>Charges</u>	<u>Charges</u>	<u>Charges</u>	<u>Charges</u>
Customer Charge	385,005	\$2.75	\$2.75	\$2.75	\$2.75	\$2.75
A16 kWh Charge	192,080,000	\$0.03384	\$0.03383	\$0.03382	\$0.03381	\$0.03380

<u>Rate A-60 Revenues</u>	<u>Revenues</u>	<u>Revenues</u>	<u>Revenues</u>	<u>Revenues</u>	<u>Revenues</u>
Customer Charge	\$0	\$0	\$0	\$0	\$0
Initial Block Charge	\$2,398,118	\$2,398,118	\$2,398,118	\$2,398,118	\$2,398,118
Tail Block Charge	<u>\$1,698,075</u>	<u>\$1,697,574</u>	<u>\$1,697,072</u>	<u>\$1,696,570</u>	<u>\$1,696,068</u>
Revenue on Rate A-60	\$4,096,193	\$4,095,692	\$4,095,190	\$4,094,688	\$4,094,186

<u>Rate A-16 Revenues</u>	<u>Revenues</u>	<u>Revenues</u>	<u>Revenues</u>	<u>Revenues</u>	<u>Revenues</u>
Rate A16 Customer Charge	\$1,058,764	\$1,058,764	\$1,058,764	\$1,058,764	\$1,058,764
Rate A16 kWh Charge	<u>\$6,499,987</u>	<u>\$6,498,066</u>	<u>\$6,496,146</u>	<u>\$6,494,225</u>	<u>\$6,492,304</u>
Revenue on A16	<u>\$7,558,751</u>	<u>\$7,556,830</u>	<u>\$7,554,909</u>	<u>\$7,552,989</u>	<u>\$7,551,068</u>
Subsidy	\$3,462,558	\$3,461,139	\$3,459,720	\$3,458,301	\$3,456,882

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-62

Request:

In December 2003, the bill analysis in Docket No. 3571 indicated that the typical residential A-60 customer used 380 kWh per month. In June 2003, the bill analysis in Docket No. 3508 indicated that the typical residential A-60 customer used 380 kWh per month. Now, in June 2004, it appears the typical residential A-60 customer is using 500 kWh. What is the rationale for setting the discounted block at the first 500 kWh used for an A-60 customer?

Response:

The initial block for the proposed Rate A-60 is set at a level of 500 kWh because this is approximately equal to the estimated class average usage per customer per month. For calendar year 2000 through 2003, the average monthly usage for this class was:

2000	455 kWh
2001	461 kWh
2002	485 kWh
2003	508 kWh

The typical bill analyses presented in Docket No. 3508, Exhibit JAL-5 and 3571, Exhibit JAL-10–Hearing Update do not indicate average monthly usage. The purpose of a typical bill analysis is to show the bill impacts of the rates proposed for different monthly kWh usage levels. The last column in each of the tables shows the percentage of all bills rendered during the period upon which the analysis was based with monthly kWh usage at the level indicated. For example, Exhibit JAL-10–Hearing Update, page 4 of 23 (attached) shows the typical bill analysis for Rate A-60 without controlled water heating. This analysis indicates that approximately 38% of all bills rendered during the analysis period, calendar year 2002, were for usage of 380 kWh per month or less. However, the class average usage per customer per month for calendar year 2002 was 485 kWh.

The bill impact analysis presented in Exhibit 6 of the settlement is presented in a slightly different format than the bill impact analyses presented in previous dockets and is intended to show the bill impacts on individual customers rather than on typical bills. The final column of each table indicates the number of customers whose average annual usage during the test period fell within the blocks indicated.

Prepared by or under the supervision of: Jeanne A. Lloyd

The Narragansett Electric Company
 Calculation of Monthly Typical Bill
 Comparison of Rates in Effect 12/31/03 v. 01/01/04
 Impact on A-60 Rate Customers
 Without Control Credit for Water Heater

Date: 21-Jul-04
 Time: 03:22 PM

Monthly kWh	Rates in Effect 12/03		Rates in Effect 01/04		Increase/(Decrease)		Percent of Bills
	Total	Standard Offer "Wires"	Total	Standard Offer "Wires"	Amount	% of Total	
95	\$9.30	\$5.44	\$9.59	\$5.84	\$0.29	3.1%	2.0%
190	\$18.61	\$10.89	\$19.18	\$11.68	\$0.57	3.1%	1.0%
380	\$37.20	\$21.77	\$38.35	\$23.35	\$1.15	3.1%	35.0%
550	\$53.85	\$31.51	\$55.51	\$33.80	\$1.66	3.1%	22.0%
750	\$73.43	\$42.97	\$75.69	\$46.09	\$2.26	3.1%	15.0%

Rates in Effect 12/03: A-60

Customer Charge	\$0.00
Transmission Energy Charge (1)	kWh x \$0.00401
Distribution Energy Charge	kWh x \$0.02589
Transition Energy Charge	kWh x \$0.00944
C&LM Adjustment	kWh x \$0.00230
S.O. Adj.	kWh x \$0.00000
FAS 106 Adjustment, & Settlement Cr.	kWh x -\$0.00038
A-60 Rate Credit	kWh x -\$0.00227
Gross Earnings Tax	4.00%
Standard Offer Charge	kWh x \$0.05500

Rates in Effect 01/04: A-60

Customer Charge	\$0.00
Transmission Energy Charge (2)	kWh x \$0.00380
Distribution Energy Charge	kWh x \$0.02589
Transition Energy Charge	kWh x \$0.00855
C&LM Adjustment	kWh x \$0.00230
S.O. Adj.	kWh x \$0.00000
Settlement Cr.	kWh x -\$0.00038
A-60 Rate Credit	kWh x -\$0.00227
Gross Earnings Tax	4.00%
Standard Offer Charge	kWh x \$0.05900

Note (1): Includes Transmission Adjustment Factor of \$0.00063/kWh.

Note (2): Includes Transmission Adjustment Factor of \$0.00042/kWh.

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-63

Request:

What evidence is there to support the position that disallowance of only 25% of the deferred uplift charges is appropriate?

Response:

The disallowance of 25% of the deferred uplift charges was part of the negotiations resulting in the Settlement. It represents the percentage of the costs that Narragansett would have not recovered through reduced earnings if it had been unable to recover the expenses that were incurred to provide service to customers through its Transmission Service Cost Adjustment Provisions. In fact, Narragansett believes that the Company is entitled to collect 100% of the deferred uplift charges for the following reasons:

- (1) Narragansett had the right to recover 100% of the uplift cost under the provisions of the Utility Restructuring Act ("URA") that applied to those costs;
- (2) Federal preemption applies to the wholesale standard offer service agreements;
- (3) These prudently-incurred costs should flow through the terms of the Transmission Service Cost Adjustment Provision; and
- (4) The Company has fully mitigated its exposure under the agreements.

These legal arguments are set out more fully below.

(1) STATE LAW ALLOWS 100% RECOVERY

(a) Narragansett has fully complied with the Price Cap Provision in the Original URA

When the URA was enacted, the law contained a price cap mechanism that fundamentally altered traditional prudence review by the Commission. The language from section 39-1-27.3(d) is quoted below:

The standard offer shall be priced such that the average revenue per kilowatt-hour received from the customer for such power together with approved distribution, transmission and transition charges shall be equal to the price that would have been paid under rates in effect during the twelve (12) month period ending September 30, 1996 adjusted annually for eighty percent (80%) of the change in the consumer price index for the immediately preceding twelve (12) month period, and also for other factors reasonably beyond the control of the electric distribution company and its former wholesale power supplier including but not limited to changes in federal, state or local taxes or extraordinary fuel costs; provided, however, that adjustments to the standard offer for factors other than inflation must be approved by the commission. The standard offer is to be a price

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

cap and may, after notice to the commission, be less than the maximum allowed at anytime for the generation component of the standard offer. (emphasis added)

The last sentence of the quoted language established a price cap mechanism. In other words, as long as the total price to the customer was below the statutory price cap, the Company was authorized by law to charge the rate. In fact, the statutory scheme contemplated that the Company could charge less than the statutory price cap, as long as it provided notice to the Commission. But there was no cost-based test for determining the standard offer price. Rather, the statutory scheme exchanged cost of service rate-making for a regulatory pricing mechanism that placed a price cap on the Company. As a result, there was no longer a "prudency" review to determine the recovery of the power supply cost for standard offer service.

Accordingly, as originally passed, the price cap mechanism created head room for the Company to recover all of its costs associated with the standard offer, as long as the price for the service did not exceed the price cap. The Company, in fact, entered into all of its standard offer contracts in reliance on this statutory scheme.

Later, the URA was amended. One of the amendments eliminated the price cap mechanism and a prudency standard was substituted on a going-forward basis for new commitments. Because the Company had relied on the prior statutory scheme when it entered into the arrangements prior to passage of the amendment, however, the statute very carefully delineated the standard that would be applied to cost recovery, as quoted below:

The electric distribution company will be entitled to recover its costs incurred from providing the standard offer arising out of: (1) wholesale standard offer supply agreements with power suppliers in effect prior to January 1, 2002; (2) power supply arrangements that are approved by the commission after January 1, 2002; (3) power supply arrangements made pursuant to § 39-1-27.3; and (4) any other power supply related arrangements prudently made after January 1, 2002 to provide standard offer supply or to mitigate standard offer supply costs; provided, however, to the extent there are any cost recovery matters relating to the provision of standard offer service that have been deferred and are pending before the commission as of the effective date of this section, such cost recovery matters shall be governed by the statutory provisions in effect on the date of the action of the commission to defer its decision on the cost recovery matter. (emphasis added)

At the time of enactment of the amendment, it was understood that the issue of uplift cost recovery was pending before the Commission. As a result, the proviso underlined above was added. The purpose of the provision was to make clear that, when determining whether the Company could recover the uplift cost that had been deferred, the standard in place in the statute prior to the amendment would be applicable. Accordingly, the prior version of the statute applies to the analysis of Narragansett's deferred uplift charges.

Thus, the resolution of this issue in the Settlement, the determination of recovery of the uplift costs would not depend upon the outcome of a prudency review. Rather, it would depend

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

upon whether the Company's standard offer pricing (including the cost of uplift) resulted in the statutory price cap being exceeded at any time. In this case, there is no year in which the standard offer price cap was exceeded, nor would it have been exceeded, as a result of the uplift cost incurred. Thus, the Company had a statutory right to recover 100% of the uplift cost under the law.

(b) The Commission Approved the Competitive Bidding Process in 1998

In addition to the above, there is another fundamental reason why the statutory scheme allows recovery of these costs. Under the statute, the standard offer was required to be put out to bid. As long as the standard offer bidding requirements were met, then the Company met the only other statutory requirement for the standard offer. In fact, NEP and Narragansett Electric completed the plan described to the Commission in Docket No. 2540 by entering into a series of agreements with USGen New England, Inc. ('USGenNE') under which the Companies agreed to divest their entitlements in their non-nuclear generation facilities, transfer their power contracts to USGenNE, and assign the responsibility to provide Narragansett Electric's wholesale standard offer requirements from NEP to USGenNE, which was filed with and approved by FERC. As part of that transaction, USGenNE agreed to assume NEP's obligation to supply wholesale standard offer service to Narragansett Electric and included a wholesale standard offer service contract in its filing to implement that agreement. See Attachment 3 to Docket 3616. In that agreement, Narragansett Electric reserved its right to put the wholesale standard offer service out to bid as required under R.I.G.L. Section 39-1-27.3(d).

The URA required Narragansett Electric to put the contract for wholesale standard offer supply out for competitive bid. Narragansett Electric's power contracts with NEP, USGenNE and TransCanada preserved that option, and Narragansett Electric exercised the bidding option in late 1997 and early 1998. The results were provided to the Commission in Docket No. 2715. *Id.* As explained in that docket, Narragansett Electric put the wholesale standard offer supply agreement out for bid in the first quarter of 1998. Qualifying bids were required to be equal to or lower than the wholesale standard offer rates contained in the restructuring settlement agreement and the USGenNE/TransCanada contracts. No bids were received. Based on this activity, the Commission found that Narragansett Electric had complied with the competitive bidding requirement of the statute. Order No. 15639, at 11 (issued July 10, 1998). Part of the cost of standard offer service was the terms of the contract that contained the requirement that Narragansett would be responsible for uplift costs. No other bidder submitted any other bid. Therefore, under the statutory scheme, there was no other option available to the Company except the USGen and TransCanada contracts, which effectively won the bid through the statutory process. Accordingly, the Commission does not have the authority to disallow any costs arising out of the price and terms that were approved through the statutorily imposed competitive bidding process.

(2) FEDERAL PREEMPTION APPLIES TO THESE CONTRACTS

There is yet another fundamental legal reason why the Company is entitled to recover 100% of the uplift costs. Specifically, the Commission does not have the authority to disallow the costs that flow from a FERC-jurisdictional contract that was accepted by FERC.

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Narragansett Electric Co. v. Burke, 119 R.I. 559, 565 (1977). In this case, FERC approved the terms of the wholesale standard offer agreements with USGen and TransCanada. Initially, the contract with USGen was filed at FERC and FERC approved the terms of Narragansett's wholesale standard offer service agreement with its suppliers in its order approving the proposed disposition by NEP and Narragansett Electric (together "Companies") of certain jurisdictional facilities as part of the Companies' sale of substantially all of their non-nuclear generation assets to USGenNE (the "Divestiture Transaction"). 82 FERC ¶ 61,179 (Feb. 25, 1998); 83 FERC ¶ 61,275 (June 10, 1998). FERC later accepted the terms of Narragansett's wholesale standard offer service agreement yet again when TransCanada Power Marketing, Ltd. ("TransCanada") assumed 9.22% of USGenNE's standard offer service obligation associated with the Company's distribution service in Rhode Island and Massachusetts.

Specifically, on October 29, 1997, while the USGenNE transfer petition was pending at FERC and prior to its closing, USGenNE agreed to transfer several rights and obligations related to the Ocean State Power projects to TransCanada and assigned an undivided 9.22 percent portion of the wholesale standard offer contract with Narragansett to TransCanada. Thus, on October 29, 1997, the wholesale standard offer service contract was amended and restated into two separate agreements to facilitate the assignment of certain contract rights by USGenNE to TransCanada. FERC approved this sale and assignment of the wholesale standard offer contract in Docket EC98-18-000, 83 FERC ¶ 61,161 (May 14, 1998).

In each of these instances FERC accepted the terms of the contracts. Once such a contract rate and terms and conditions related thereto are accepted by FERC, the Commission must allow recovery of those costs incurred under the terms of the contract as a reasonable operating expense. See *Mississippi Power v. Miss. Ex rel Moore*, 487 U.S. 354, 374 (1988); *Nantahala Power & Light v. Thornburg*, 476 U.S. 953, 965 (1986). The Supreme Court has concluded that "a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." *Nantahala Power & Light*, 476 U.S. at 965. Once FERC sets a rate, a state may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. *Id.* at 966. A State must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority. *Id.* Moreover, the Rhode Island Supreme Court has found that "jurisdiction to determine the reasonableness of the wholesale rate charged [by NEPCO] to Narragansett rests exclusively with the FPC" (the predecessor to FERC). *Narragansett v. Burke*, 119 R.I. at 565. Thus, it is not appropriate or legally sustainable at this time for the state regulators to reexamine the underlying wholesale contract that FERC has found to be reasonable.

Moreover, the *Pike County Light & Power Co. v. Pennsylvania Pub. Util. Comm'n*, 465 A.2d 735 (Pa. Comm. Ct 1983) exception does not apply in this instance. The *Pike County* exception stands for the proposition that a state utility commission can, without infringing on FERC's determination of the reasonableness of the price and other terms of a wholesale sale, review the "prudence" of the purchasing utility's decision "to incur such costs in light of available alternatives." *Id.* at 738. This is clearly not the current circumstance. In this case, there is no challenge to the decision to purchase power under the contract from these wholesale suppliers. In fact, as more fully described below, Narragansett Electric put the initial wholesale standard

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

offer contract out to bid pursuant to the provisions of Rhode Island's Utility Restructuring Act ('URA'). The Company reported its findings to the Commission in Docket No. 2715 and the Commission approved the competitive bidding process. Order No. 15369 (issued July 10, 1998). Accordingly, the facts do not warrant a *Pike County* analysis. Recently, in *Entergy Louisiana v. Louisiana PSC*, US Supreme Court 02-299 (June 2, 2003), the Supreme Court held that an 'automatic adjustment' clause in an operating agreement among affiliated utilities -- which allowed an operating committee of the companies to allocate costs among the affiliates -- was a FERC-filed tariff. As a FERC-jurisdictional tariff, it preempted state regulation which would have 'trapped' costs incurred by the utility at the wholesale level. Under *Nantahala, Mississippi P & L*, and *Entergy*, the WSOS agreement constitutes a filed rate that cannot be changed (except prospectively, via a Section 206 proceeding). As the Supreme Court pointed out in *Entergy*, it doesn't matter whether a specific provision of a contract was actually discussed or litigated.

(3) THE COSTS WERE PRUDENTLY-INCURRED

Even if a prudency review were to be applied to the cost incurrence, there would be no basis for denial of cost recovery. Narragansett acted prudently when it entered into its Wholesale Standard Offer Service Agreements. At the time that New England Power Company and Narragansett Electric divested all of their generation, they obtained a highly favorable price for the generating business. The amount received for the business was \$1.6 billion, which was used to reduce the Company's stranded costs for the benefit of customers. USGen, however, would not have paid the price it did for the business had it been required to assume the liability for uplift costs. That is, USGen may still have purchased the business, but USGen would have discounted the overall purchase price in the absence of obtaining a concession in the Wholesale Standard Offer Service Agreements that removed that risk. For that reason, there is no basis for assuming that Narragansett could have insisted on different language in the contract pertaining to responsibility for uplift costs with no adjustment to the purchase price. The inclusion of the proviso that ultimately freed USGen of the responsibility to pay for uplift cost, therefore, likely produced a benefit to customers in the form of a higher up front purchase price for the business.

(4) THE COMPANY HAS FULLY MITIGATED ITS EXPOSURE

Narragansett Electric also has acted reasonably to fully mitigate any additional cost incurrence with regard to the wholesale standard offer service agreements. As soon as NEPOOL filed new and revised market rules, which prompted the instant dispute, Narragansett Electric prepared and presented numerous FERC filings regarding the allocations. See Attachment 8 in Docket 3616. Eventually, Narragansett Electric's position was approved by FERC and on July 3, 2002, FERC agreed to change the allocation process, ordering ISO-NE to revise the tariff effective July 1, 2001. 100 FERC ¶ 61,029 (2002). Additionally, Narragansett Electric initiated the formal dispute resolution process under the wholesale standard offer service agreement that included negotiation, mediation, and arbitration. Narragansett Electric vigorously pursued the matter, ultimately resulting in the arbitration decision. Narragansett Electric pursued the litigation in order to reduce its customers' expense. Even though the Company was

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

unsuccessful in convincing the arbitrators that all ISO-NE tariff costs should have been borne by the wholesale suppliers, that does not deny Narragansett Electric the ability to collect its actual deferred incurred expenses associated with serving its customers pursuant to the WSOS Agreements.

The Wholesale Standard Offer Agreements, which were part of the underlying wholesale restructuring settlement that was agreed to by Narragansett, NEP, the Commission and the Rhode Island Division of Public Utilities and Carriers (Division), are compliant with the URA and have been approved by the Federal Energy Regulatory Commission (FERC). Accordingly, based on both state law and principles of federal preemption, the Company should recover these costs. Moreover, when the disputed costs arose, Narragansett mitigated these costs as much as possible. The Company contested the allocation of the disputed costs and the wholesale suppliers' arguments in numerous FERC proceedings, eventually resulting in a FERC order that required ISO-NE to revise its tariff regarding the allocation process. Narragansett also mediated and fully arbitrated this issue with one of the wholesale suppliers in an attempt to reduce its customers' exposure regarding these ISO-NE tariff costs. Accordingly, the Company is entitled to collect from customers the deferred expenses consisting of the ISO-NE charges set forth on Attachment 19 to the Statement of Facts submitted in Docket 3616, related to the provision of Standard Offer Service by the Company's wholesale suppliers.

For all the above reasons, the Company believes it is entitled to full cost recovery of the deferred expenses. In the spirit of settlement, however, it agreed to disallow 25% of the deferred uplift charges.

Prepared by or under the supervision of: Legal Department

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-64

Request:

Please explain why 25% of the \$7.45 million in deferred uplift costs were disallowed while ratepayers are expected to pay 100% of future uplift costs under those same WSOS contracts.

Response:

See response to Commission Data Request 1-63.

Prepared by or under the supervision of: Legal Department

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-65

Request:

Why should the Service Quality Plan remain essentially unchanged from the one approved as part of the 2000 Settlement?

Response:

The Settlement in Section 14 at page 25 provides that the currently approved Service Quality Performance Standards will remain in effect until the Commission completes its review of the standards that Narragansett is scheduled to begin with a filing in August of this year. This proceeding will allow the Commission to review and adjust the Standards. The Settlement does, however, specify that the maximum penalty will not be changed, the offset mechanism will remain in place, and the Standards will continue to be based on historic performance. These conditions assure that any revisions to the Standards will not adversely affect the economics of the Settlement by either increasing or reducing the risk or the magnitude of the penalties under the Service Quality Performance Standards.

Prepared by or under the supervision of: Robert H. McLaren

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-66

Request:

Why should Narragansett Electric's penalty under the Service Quality Plan not be set at 1% of its new distribution revenue requirement?

Response:

The Company proposes to keep its maximum penalties under the proposed new Service Quality Plan at the current level of \$2.4 million, which equates to about 1.1% of distribution revenues. As explained in the response to request 1-65, this agreement maintains the economic value of the Settlement for the Parties to the Agreement.

Prepared by or under the supervision of: Robert H. McLaren

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-67

Request:

Why should the Commission continue with offsets in Narragansett Electric Company's Service Quality Plan if it rejected offsets in New England Gas Company's Service Quality Plan?

Response:

The offsets maintain the economic value of the Settlement as explained in the responses to Requests 1-65 and 1-66. Moreover, the Company believes the current level and operation of offsets is reasonable and should be continued. Offsets provide an incentive for a company to strive to exceed performance benchmarks, not just meet them. Offsets between performance metrics also foster a great sense of 'teamwork' within the Company, as exceptional performance in one function may help to mitigate below average performance in another area.

The inclusion of both penalties and penalty offsets shifts the Company's focus beyond just avoiding penalties towards continuous improvement, holds out the promise of penalty offsets to encourage the pursuit of service quality excellence and encourages investment in long-term cost-effective service quality improvements. The opportunity to earn penalty offsets significantly increases the significance of the individual performance measures under the Company's Service Quality Plan, because superior performance under the measure provides positive assistance throughout the year, even when it is clear that penalty is unlikely to occur under the specific measure. Absent offsets, the significance of the measure declines when the standard itself is likely to be achieved, and a penalty avoided. With the offset mechanism, the Service Quality Plan provides a continuing incentive to improve performance through the end of the year to help mitigate penalties that may occur in other areas.

Application of a penalty offset also offers real value that can support a service quality improvement during the period of the rate plan. For example, our economic analysis of a new program or technology would consider the potential economic value associated with penalty offsets that are likely to be produced by the new program. Thus, maintaining the opportunity to earn and apply penalty offsets provides both the proper signal and the potential resources to support the continuous improvement of our service. Because penalties can be avoided by doing business as usual, a penalty-only system (with no offset opportunity) will not be nearly as effective in promoting improvements in service.

Prepared by or under the supervision of: Robert H. McLaren

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-68

Request:

Why should the standards set under the Service Quality Plan not be based on peer performance or performance by Narragansett Electric and the EUA Companies prior to the merger?

Response:

The Settlement continues the use of historic data to assure that the economic value of the Settlement is maintained under the new Service Quality Plan. The use of the Company's own experience also assures that the data are collected and applied consistently throughout the period of the analysis. For example, the Company generally uses up to ten years (1994 through 2003) of Company data, which includes the use of aggregated data from Narragansett Electric, Blackstone Valley Electric and Newport Electric prior to the consummation of the merger in 2000. The use of Company data assures that it is collected and analyzed consistently and that the results represent a clear trend line of performance.

In contrast, the use of peer data creates significant comparability issues. Each utility maintains its own protocols for collecting data, excluding events, and maintaining records. Moreover, the fundamental differences in utility systems also create comparability issues. For example, each distribution company has different percentages of underground versus overhead facilities, different system designs and different data collection capabilities and methods. These differences undermine the consistent evaluation of performance that is central to standard setting and performance evaluation. Until consistent data and measurement protocols are established for the industry, the benefits of standards set based on peer data are outweighed by the additional complexity and uncertainty associated with the administration of the program to ensure comparability. Thus, although peer comparisons may be valuable in some circumstances to determine performance on a general level, they should not be used to establish service targets under specific Service Quality Standards.

Prepared by or under the supervision of: Robert H. McLaren

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-69

Request:

What is the rationale for the Company avoiding payment on service quality penalties until the end of the rate freeze period?

Response:

The Service Quality Plan that is now in place includes the potential that reliability penalty offsets may be applied in the year earned, *or in the subsequent year*. As a result, the aggregation of service quality penalties over the rate freeze period is necessary for the proper administration of the standards. Narragansett believes that this approach is reasonable for the reasons provided in the response to Request 1-67. The opportunity to use outstanding performance to offset penalties that may occur in a following year assures that the Company will seek continuous improvement and outstanding performance in all areas of its business, because that outstanding performance may have real economic value in the mitigation of penalties in other functions or in other years.

Prepared by or under the supervision of: Robert H. McLaren

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-70

Request:

Does the Company pay interest on any service quality penalty?

Response:

Neither the original nor the new proposed Service Quality Plan includes a provision for the accumulation of interest on any service quality penalty.

Prepared by or under the supervision of: Robert H. McLaren

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-71

Request:

Please explain Part 5(B)(5) in sufficient basic detail so that the non-fiscal staff member can explain it to a member of the public.

Response:

Section 5 of the Settlement deals with depreciation rates and tax normalization. The section continues the provisions of the Current Settlement without change. As a result, no specific action by the Commission is requested or required under this section of the Settlement.

The relationship between book depreciation and tax depreciation can best be explained to non-fiscal people through a simple example. Depreciation expense is designed to reflect on the Company's books a portion of a capital item of plant that is "used" during the course of a year. Unlike an expense item that is recognized immediately on the Company's books when it is incurred, capital items are meant to be used for an extended period of years. Depreciation "expenses" the capital value of the asset over the asset's expected useful life. The depreciation expense is booked to a depreciation reserve that is then designed to provide the cash to buy a new replacement asset at the end of the first asset's useful life. For example, if a company had an asset with an original cost of \$100 and an estimated useful life of ten years, it would record depreciation expense of \$10 per year for ten years and at the end of that period have \$100 in the reserve to buy a new \$100 asset to replace the first one. In the case of utilities, Commission approval is generally required prior to changing depreciation rates or lives. As indicated at the outset, Narragansett is not proposing any changes in this proceeding.

Just as the Company develops depreciation expense for book purposes, it must also establish depreciation expense for tax purposes. The income tax code usually allows much more rapid depreciation for tax purposes than utility commissions allow for book purposes. This accelerated tax depreciation takes many forms—shorter plant tax lives, accelerated deductions in the early years, or in the case of the Bonus depreciation exogenous factor in this case, specific extra depreciation allowances. The faster depreciation is designed to stimulate capital investments and help the economy. For purposes of the simple example, assume Congress authorized a shorter tax life of five years for the \$100 asset in the prior paragraph. The Company would then be able to take a \$20 per year tax deduction while only having a \$10 per year depreciation expense. After five years, the asset would be completely written off for tax purposes, but the Company would only have depreciated \$50 dollars on its books. At a 40% tax rate, the Company would have reduced its actual income tax payments by \$40 (i.e. \$100 tax expense times 40% tax rate), but would only show tax savings of \$20 on its books (i.e., \$50 book expense times 40% tax rate). The difference between the actual tax payments and book taxes is a "tax timing difference" that creates a normalized tax. The Company recognizes that it has an additional \$20 of tax savings that have been realized from the government, and treats those savings as contributed capital that reduce rate base. After ten years, when the book depreciation

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

of the asset is completed, the tax timing difference "turns around" and the deduction for book purposes matches the deduction for tax purposes. The rate base credit is eliminated.

In prior years, many commissions decided that the actual tax payments should be "flowed through" immediately to customers, and set electric rates based on the actual tax depreciation, rather than the lower book depreciation rates. The Internal Revenue Code now largely prohibits this practice, and requires the tax benefits from faster tax than book depreciation be "normalized."

The other terms in section 5 deal with the treatment of specific items associated with plant. For example, the accounting profession realized that the replacement of an asset required the company to pay the cost of removing the old asset as well as the installation of the new one. As a result, depreciation expense now includes an allowance for cost of removal for book purposes. The tax code requires that cost of removal be expensed as incurred, creating a book-tax difference that is normalized in the cost of service. The financing costs of the construction project before it is put into service is also a difference between the books of the company and the tax return. Equity AFDC is added to the book cost of the plant, but not the tax cost. Finally, in addition to accelerated depreciation, the tax code has at times in the past provided a direct tax credit for eligible investments in capital projects. For Narragansett, this "Investment Tax Credit" or "ITC" is amortized back to customers over the life of the asset, although the credit is not excluded from rate base.

With regard to Tax Normalization, the proposed Settlement maintains full normalization practices for all book/tax timing differences, with the exception of depreciation of equity allowance for funds used during construction ("AFDC") and investment tax credit ("ITC") basis differences and ITC amortization which are not to be considered book/tax timing differences and which aggregated approximately \$260,000 in reduced income tax expense as reflected in the Company's earnings report for 2003.

The proposed Settlement also provides for the continuation of the normalization of Cost of Removal expenditures, as included in Section 9 of the Current Settlement. Cost of Removal expenditures which are expensed for tax purposes are not expensed for book purposes but rather charged to the Company's reserve for depreciation pursuant to Generally Accepted Accounting Principles. This different treatment produces another example of a book/tax timing difference which if not normalized would produce a liability for future rate payers.

Prepared by or under the supervision of: Michael D. Laflamme

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-72

Request:

Please provide the evidence upon which the Commission-approved depreciation rates were based in the 2000 Settlement.

Response:

The basis for the depreciation rates approved as part of the Current Settlement is described in the pre-filed testimony of David M. Webster dated May 20, 1999, filed in Docket No. 2930. The depreciation rates themselves were established as part of the settlement in Docket No. 2290, dated May 9, 1996, which was attached as an exhibit to Mr. Webster's testimony. A copy of the settlement in Docket No. 2290 is attached hereto.

Prepared by or under the supervision of: Michael D. Laflamme

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE:	NARRAGANSETT ELECTRIC COMPANY: REQUEST FOR RATE INCREASE))))	Docket 2290
--------	---	------------------	-------------

SETTLEMENT ON
DEPRECIATION EXPENSE

I. Introduction

On November 14, 1995, the Public Utilities Commission (Commission) approved settlement agreements (dated September 8, 1995 and September 14, 1995, as modified by a Supplemental Settlement dated October 11, 1995 – together, the “Settlement”) between The Narragansett Electric Company (Narragansett or the Company), the Energy Council of Rhode Island (TEC-RI), and the Division of Public Utilities and Carriers (Division). The Settlement resolved all the outstanding issues in Docket 2290 except for the appropriate depreciation rates to be used for Narragansett. As part of the Settlement, the parties agreed to complete, by January 31, 1996, a review of the depreciation study filed by Narragansett in the rebuttal phase of Docket 2290. The Settlement further states that if the parties reach agreement on the appropriate depreciation rates to be used for Narragansett, the rates may be submitted by Narragansett, without opposition by the Division, in Narragansett’s next base rate proceeding. This Settlement reflects such an agreement by the Division and Narragansett.

II. Stipulation and Settlement

After extensive discussion and review by experts retained by both the Company and the Division, the Parties have reached agreement on the appropriate depreciation rate methods to be used for Narragansett without opposition by the Division, in Narragansett's next base rate proceeding filed pursuant to § 39-3-11, as follows:

- (A) Narragansett shall change from the Broad Group Whole Life Method of depreciation to the Vintage Group Remaining Life Method of depreciation. These changes are recommended to better achieve the goals and objectives of depreciation accounting through the use of a procedure that distinguishes service lines among vintages and provides cost apportionment over the estimated weighted average remaining life of a rate category.
- (B) For Transmission Plant, the lives shall be as set forth in Attachment A – Projection Life-Transmission Plant (the same as proposed earlier in Docket 2290).
- (C) For Distribution Plant, Narragansett shall use the same lives as currently prescribed and specified on Attachment A.
- (D) For General Plant, the life for account 390, (Structures and Improvements), shall be reduced from 50 years to 40 years. For other General accounts, Narragansett shall use an amortization period of 20 years.
- (E) For Salvage, transmission salvage shall be set at -20%. Distribution salvage shall be set at -10%.

III. Miscellaneous Provisions

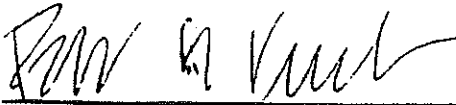
- (A) Unless expressly stated herein, the making of this settlement establishes no principles and shall not be deemed to foreclose any party from making any contention in any other proceeding or investigation.
- (B) Unless expressly stated herein, the acceptance of this settlement by the Commission shall not in any respect constitute a determination by the Commission as to the merits of any issue in any rate proceeding for this Company or another.
- (C) This settlement is the product of settlement negotiations. The content of those negotiations is privileged and all offers of settlement shall be without prejudice to the position of any party.
- (D) This settlement is submitted on the condition that it be approved in full by the Commission, and on the further condition that if the Commission does not approve it in its entirety, it shall be deemed withdrawn and shall not constitute a part of the record in any proceeding or used for any purpose.
- (E) The Attachments referenced in and attached to this settlement shall be deemed an integral part hereof. In the event that any inconsistency exists between the provisions of this settlement and the Attachment hereto, the provisions of this settlement shall supersede the provision of any such Attachment.

IV. Conclusion

WHEREFORE, the Division and Narragansett respectfully request the Commission approve this Settlement to resolve all depreciation rate issues in Docket 2290.

DATED AT PROVIDENCE, this 9th day of May, 1996.

**THE DIVISION OF PUBLIC
UTILITIES AND CARRIERS**



Patricia M. French, Esq.
Assistant Attorney General
150 South Main Street
Providence, RI 02903
(401) 274-4400

**THE NARRAGANSETT
ELECTRIC COMPANY**



Craig L. Eaton, Esq.
Thomas G. Robinson, Esq.
280 Melrose Street
Providence, RI 02907
(401) 784-7526

**NARRAGANSETT ELECTRIC COMPANY
SETTLEMENT OF DEPRECIATION RATES**

Narragansett Electric
BVE/Newport Electric
R.I.P.U.C. No. _____
Exhibit DMW-1
Page 5 of 5

Depreciation System

Current: Straight line method, broad group procedure, whole life technique.

Settled: Straight line method, vintage group procedure, remaining life technique for all but accounts 391 through 398, which are to follow amortization accounting.

<u>Projection Life - Transmission Plant</u>			Proposed in Rate	
<u>Account</u>		<u>Current</u>	<u>Filing</u>	<u>Settlement</u>
352.00	Structures and Improvements	60.00	50.00	50.00
353.00	Station Equipment	35.00	55.00	55.00
354.00	Towers and Fixtures	65.00	50.00	50.00
355.00	Poles and Fixtures	40.00	45.00	45.00
356.00	Overhead Conductors and Devices	45.00	40.00	40.00
357.00	Underground Conduit	75.00	50.00	50.00
358.00	Underground Conductors and Devices	50.00	40.00	40.00
359.00	Roads and Trails	65.00	60.00	60.00
	Estimated Annualized 1995 Accrual (\$000's) *	\$1,078	\$859	\$859
<u>Projection Life - Distribution Plant</u>				
361.00	Structures and Improvements	50.00	40.00	50.00
362.00	Station Equipment	35.00	45.00	35.00
364.00	Poles Towers and Fixtures	25.00	32.00	25.00
365.00	Overhead Conductors and Devices	35.00	33.00	35.00
366.00	Underground Conduit	60.00	50.00	60.00
367.00	Underground Conductors and Devices	45.00	35.00	45.00
368.00	Line Transformers	25.00	27.00	25.00
369.00	Services	25.00	35.00	25.00
370.00	Meters	30.00	27.00	30.00
371.00	Installation on Customer Premises	35.00	20.00	35.00
372.00	Leased Property on Customer Premises	15.00	15.00	15.00
373.00	Street Lighting and Signal Systems	25.00	17.00	25.00
	Estimated Annualized 1995 Accrual (\$000's) *	\$12,776	\$13,703	\$12,706
<u>Projection Life - General Plant</u>				
390.00	Structures and Improvements	50.00	40.00	40.00
391.00	Office Furniture and Equipment	25.00	15.00	20.00
393.00	Stores Equipment	35.00	15.00	20.00
394.00	Tools Shop and Garage Equipment	30.00	15.00	20.00
395.00	Laboratory Equipment	25.00	15.00	20.00
397.00	Communication Equipment	10.00	15.00	20.00
398.00	Miscellaneous Equipment	25.00	15.00	20.00
	Estimated Annualized 1995 Accrual (\$000's) *	\$420	\$542	\$495
<u>Salvage</u>				
108.50	Transmission	0.00	-20.0%	-20.0%
108.60	Distribution	0.00	-15.0%	-10.0%
108.70	General	0.00	-5.0%	-5.0%
	Estimated Annualized 1995 Accrual (\$000's) *	\$0	\$2,326	\$1,626
	Total Estimated Annualized 1995 Accrual (\$000's)*	\$14,274	\$17,430	\$15,686

* Estimated annualized accruals are based on 1994 electric plant in service amounts in FERC account 101.

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-73

Request:

Please explain why the continuation of the depreciation rates referenced above is appropriate.

Response:

Please see response to Commission Data Request 1-71. As explained there, the change in depreciation rates requires Commission approval, generally after a study is prepared that indicates a change is necessary. The Settlement proposes no changes to depreciation rates in this case.

Prepared by or under the supervision of: Michael D. Laflamme

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-74

Request:

Please explain the normalization practices that were approved in the 2000 Settlement, referred to in Part 5(B)(5) of the Proposed Settlement. Does this provision mean that if Narragansett has an expense associated with physical removal of equipment or fixtures, it can deduct the expense for tax purposes, but cannot deduct the expense for shared earnings calculations? If not, please explain.

Response:

Yes. For tax purposes, the Company realizes a tax deduction for Cost of Removal expenditures as incurred but, pursuant to Generally Accepted Accounting Principles, cost of removal expenditures are not expensed for book purposes but rather are charged to the reserve for depreciation. The Current Settlement as well as the proposed Settlement provide for the normalization of this book/tax timing difference. See also the response to Commission data Request 1-71.

Prepared by or under the supervision of: Michael D. Laflamme

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-75

Request:

What is the rationale for eliminating another proof of savings in 2007?

Response:

The Parties have agreed under Section 4 of the Settlement that this case represents the second proof of savings under the Current Settlement, and are requesting the Commission to make that finding. Such a finding is reasonable given the provisions of the Settlement.

Under the Current Settlement, the second savings verification could occur at the first cost of service rate case filed by the Company to change rates after January 1, 2005. Absent the filing of such a cost of service case by the Company, the second verification would occur by April 30, 2007. Under the Settlement, however, the Company would implement a substantial base distribution rate reduction of \$10.243 million well before the current second savings proof date in 2007, and even before the expiration of the current rate freeze period which continues through 2004. This base rate reduction includes \$5.0 million for the customers' share of shared savings, and would remain in effect for over five years (through 2009). Further, the Settlement fixes the Company's share of shared savings that can be reflected in its cost of service for purposes of calculating earnings at \$4.645 million. This amount, the calculation of which is set forth in Exhibit 1, page 3 of 3 of the Settlement, is substantially lower than the amount originally filed for in the first savings proof in Docket No. 2930, and is also lower than the \$5.0 million customer share of shared savings reflected in the Settlement. The elimination of the second look also provides Narragansett with assurance that is integral consideration for the Company under the Settlement. Thus, establishing this Settlement as the second savings proof, and eliminating the need for any further savings proof, provides substantial benefits in the form of: a substantial and accelerated base rate reduction, long-term rate stability through the rate freeze, and the final determination of the Company's shared savings level at a level well below that originally filed for by the Company, and therefore is reasonable.

Prepared by or under the supervision of: Carlos A. Gavilondo

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-76

Request:

With regard to the \$4.645 million of shared savings to be retained by the Company, please provide a schedule detailing the major components of this figure.

Response:

The \$4.645 million Company shared savings amount is a settled amount, and its calculation is shown in Exhibit 1, page 3 of 3, of the Settlement. The amount was calculated by first eliminating 100 percent of the incremental pension income experienced in calendar 2002 from the Company's 2002 normalized cost of service. This adjusted 2002 actual cost of service was then compared to the adjusted benchmark cost of service for 2002, with the difference (\$9.289 million) being the total savings to be shared between the Company and customers. The \$4.645 million shared savings amount represents the Company's 50 percent of this revised total shared savings amount (although customers' share of shared savings was maintained at \$5.0 million, and is reflected as part of the \$10.243 million base rate reduction). This calculation also is described in the Note to Exhibit 1, page 1 of 3, of the Settlement.

Because the shared savings calculation is based on a comparison of the actual normalized 2002 cost of service with the benchmark 2002 cost of service, *all* of the Company's costs factor into the calculation of this amount.

Prepared by or under the supervision of: Michael D. Laflamme

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-77

Request:

In addition to calculating pension expense for the purposes of earnings reports based on FAS 87 & FAS 88, what other methods could be used to calculate pension expense? Why is the proposed method superior and other methods inferior?

Response:

Although the Commission now bases the rate allowance for pension expense on FAS 87 and FAS 88, it has in the past based pension-related rate recovery on the tax deductible contributions of the utility, rather than the expense recorded under FAS 87 and FAS 88. However, this approach can lead to a mismatch between the Company's expenses for accounting purposes and its rate recovery. In general, rate recovery should match the expenses on the utility's accounts, and match generally accepted accounting principles.

Prepared by or under the supervision of: Legal Department

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-78

Request:

Can the Commission still create regulatory assets and liabilities, specifically for pension income or expense under the Proposed Settlement?

Response:

Under Section 7(A) of the Settlement, pension expense for earnings report purposes during the Rate Freeze Period and the remainder of the Settlement Period are based on FAS 87 and FAS 88, and there is no need to create regulatory assets or liabilities for pension income or expense.

Prepared by or under the supervision of: Legal Department

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-79

Request:

Part 3(A) of the Settlement states, "For purposes of this paragraph, the term "transaction costs" includes all employee separation costs resulting from the mergers.

- (a) What was the time frame for employee separation costs resulting from the merger?
- (b) How many employees were involved?
- (c) How many of the positions, if any, were re-filled before December 31, 2004?
- (d) How many were permanently eliminated?

Response:

- a.) What was the time frame for employee separation costs resulting from the merger?

The Voluntary Early Retirement Program (VERP) and the Limited Hardship Early Decision Option (LHEDO) were both offered in the fall of 1999. Enrollees were told that benefits were contingent on completion of the merger. Upon completion of the merger in March of 2000, releases commenced and were completed for both programs by 12/31/2000.

- b.) How many employees were involved?

The VERP resulted in approximately 167 reductions; 130 at EUA (exclusive of reductions at Massachusetts regulated entities) and 37 at New England Power Service Company. The LHEDO resulted in 110 reductions, all at EUA (again, exclusive of reductions at Massachusetts regulated entities). (Note: The allocation between EUA subsidiaries is based on estimates

- c.) How many of the positions, if any were re-filled before December 31, 2004?
- d.) How many were permanently eliminated

The answers to these questions are not discreetly determinable. First, we have no system that maintains the data necessary to answer the questions. We don't have a system that tracks individual positions over time or through corporate transactions. Second, this merger cannot be viewed as the mere stacking of one company on top of another like blocks. Rather it is more akin to the combination of multiple liquids in the same jar which become almost impossible to re-segregate once combined. Third, positions often change as a result of a business combination like this. For example, a manager's job is eliminated, but an analyst position is filled, or the job is completely re-defined and it's impossible to tell what it used to be.

However, the Company can measure combined employment in the merged entities before the merger—12/31/1999—and then again after the merger. The attached worksheet shows staffing levels for the affected entities pre and post merger.

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

The net reduction shown is less than the number of VERP's and LHEDO's because there was some hiring in the interim period referenced on the table, the majority of which related to either vacancies which existed at the beginning of the period and normal workforce attrition which occurred during the period. In consideration of the limitations mentioned above, to the best of our knowledge and ability to discern, of the 277 gross merger related reductions, we estimate that 85% or 235 represented permanent reductions and the balance—42—were refills of positions for which the voluntary programs produced extra or mismatched reductions.

Prepared by or under the supervision of: Human Resources

Narragansett Electric Company
 National Grid/Eastern Utilities Merger
 Employee Separation Analysis

THE NARRAGANSETT ELECTRIC COMPANY
 R.I.P.U.C. Docket No. 3617
 Distribution Rate Plan Stipulation & Settlement
 Response to Commission's Data Request - 1 - 79

	<u>Staffing</u>	<u>Transfers</u>	<u>Transfers</u>	<u>Revised</u>	<u>VERP</u>	<u>LHEDO</u>	<u>Baseline less</u>	<u>Staffing</u>
	<u>12/31/1999</u>	<u>To Narr</u>	<u>To MECO</u>	<u>Baseline</u>	<u>Reductions</u>	<u>Reductions</u>	<u>Reductions</u>	<u>05/31/2001</u>
Narragansett Electric	511	52		563			563	671
New England Power Svc Co	1,370			1,370	(37)		1,333	1,579
Sub Total	1,881	52	0	1,933	(37)	0	1,896	2,250
Blackstone Valley	85			85	(17)		68	0
Newport Electric	50			50	(9)		41	0
EUA Svc Co.	524	(52)	(158)	314	(104)	(110)	100	0
Sub Total	659	(52)	(158)	449	(130)	(110)	209	0
Total	2,540	0	(158)	2,382	(167)	(110)	2,105	2,250

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-80

Request:

With regard to sales of properties, please indicate the criteria for a utility property versus a non-utility property. How are the proceeds for each type accounted for by the Company for the purposes of earnings?

Response:

In general, if property is used in providing the Company's utility service to customers it is considered utility property and is included in rate base upon which the Company's rates are determined. Non-utility property on the other hand is not included in the Company's rate base and therefore not supported by the Company's rates. Consequently, the Company believes that the gain or loss on the sale of utility property should be included in the Company's regulated earnings and the gain/loss on the sale of non-utility property should be excluded from regulated earnings.

Prepared by or under the supervision of: Michael D. Laflamme

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-81

Request:

What is the purpose of the Notification provision of Part 13(B)? Does the Company need approval of the sale of assets to a non-affiliate? What is the significance of \$250,000. How does such a provision affect Narragansett's bargaining power?

Response:

The notification provision reflected in Part 13(B) is a continuation of the notification provision agreed to by the settling parties as part of the Current Settlement approved by the Commission.

The Settlement in this docket does not establish any independent approval requirement for the sale of assets to a non-affiliate. Any such approval requirements would be pursuant to any applicable state and/or federal laws, regulations or regulatory orders.

The \$250,000 net book value threshold pertaining to notice requirements prior to marketing for sale any utility or non-utility real estate property is a continuation of the threshold agreed to by the settling parties as part of the Current Settlement.

The Company does not believe that the provisions of Part 13(B) will adversely affect the ability of the Company to divest of property.

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-82

Request:

What are the attachment fee revenues for 2003 and estimated for 2004?

Response:

For calendar year 2003, attachment fee revenue totals \$1,203,412. For the period January through June 2004, the Company has recorded \$601,411 of attachment fee revenue, or \$1,202,822 on an annualized basis.

Prepared by or under the supervision of: Michael D. Laflamme

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-83

Request:

Why is the 60 month payment option for an individual residential customer seeking a line extension only available for overhead extensions and not underground ones?

Response:

The 60-month payment option is only made available to individual residential customers seeking overhead line extensions in order to reduce the Company's exposure from potential customer default. Construction costs associated with underground line extensions are approximately two-times the cost of overhead construction. Offering the 60-month financing option on the more costly underground construction thus represents a higher risk to the Company.

Prepared by or under the supervision of: Michael D. Laflamme

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-84

Request:

What is the cost to the Company and/or other ratepayers of two poles, two spans of overhead line and a service drop? What percentage of requests for line extensions are fully covered by this provision?

Response:

The Company's full cost of installation for two poles and two spans of overhead line including a service drop is estimated to be approximately \$2,500. Based on new service construction completed during calendar year 2003, approximately 88% of qualifying line extension requests were fully covered by this provision.

Prepared by or under the supervision of: Michael D. Laflamme

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-85

Request:

Please provide any terms and conditions or policies regarding tree trimming, double poles, customer responsibilities or Company responsibilities in the rights-of-way or easements and along public ways.

Response:

Under the Company's currently effective line extension policies, tree trimming along public ways and common ways is the Company's responsibility, but the Company may bill the cost of such tree trimming to the customer. All responsibility for tree trimming on private property remains with the customer. The Distribution Rate Plan Stipulation and Settlement does not propose any changes in these relative responsibilities, nor does it address changes with respect to any other tree trimming policy.

With respect to maintenance trimming, feeder-based cyclical tree trimming is done on approximately a five-year cycle using contract tree crews. The trimming operation includes specific clearing specifications around all primary lines, secondary lines and service drops. Customers and municipal officials are contacted prior to the work being performed. During the trimming operation hazardous limbs and trees are also removed to help minimize tree outages. Customers are not charged for this work.

Clearing for new construction or facility rebuilds is accomplished to the same specifications as our maintenance tree trimming program. Where the scope of work is large our arborist or designee is utilized to detail the tree work to the property owners and the municipal officials prior to commencing work. Depending on the situation, for some new service projects the customer is responsible for completing the clearing or paying for the Company's vendor to complete the work, as provided for in the line extension policies.

The Company has no formal policy in place regarding double poles, but it has been actively working to reduce double poles in the State over the past few years and continues with that effort.

Prepared by or under the supervision of: Carlos A. Gavilondo

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-86

Request:

Explain the rate design and whether it is based on the Division's approach in Docket No. 3546. If not, please explain why it is appropriate.

Response:

The rate design reflected in the Settlement is not based on the Division's approach in Docket No. 3546. Rather, the rate design reflected in the Settlement is a continuation of the Company's currently effective rate design, modified by the allocation of the \$10.243 million base rate reduction proposed in the Settlement. The allocation of the proposed rate reduction is based 50% on kilowatt-hour deliveries and 50% on the normalized revenue from each rate class. Parties to the Settlement that advocated for residential, commercial or industrial rate classes could reasonably justify allocations that produced more favorable results to their respective customer classes, and thus all parties compromised to the rate reduction allocation reflected in the Settlement.

The compromise reached by the Parties is reasonable, given that, as shown on Exhibit 1 to the Settlement, roughly fifty-percent of the rate decrease is associated with the growth in kilowatt-hour deliveries, which is appropriately returned through an allocation to kilowatt-hour deliveries, and fifty-percent is associated with earned savings, which is related to the revenue requirements in each rate class.

Prepared by or under the supervision of: Carlos A. Gavilondo

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-87

Request:

Why is a performance based rate plan more beneficial to ratepayers than a traditional cost of service rate plan?

Response:

Under traditional cost of service regulation, rates are established on the basis of the utility's cost to render the service, plus a return on the utility's investment in providing that service. To the extent the utility's cost to provide service increased for whatever reason, the utility had a substantial incentive to file a rate case to increase rates. However, a utility's ability to increase its rates to recover these new costs was based on those costs having been prudent.

While traditional cost of service regulation provided discipline on utilities to manage their costs to provide service prudently, it did not necessarily establish a strong incentive to reduce costs or increase efficiencies. This is because under traditional cost of service regulation, any reduction in a utility's costs would be reflected in reduced rates in the next cost of service rate case. Thus, the incentive on the part of the utility to take steps to produce large cost reductions is attenuated under cost of service regulation, especially if the upfront costs to achieve those cost reductions are significant. As a result, traditional cost of service regulation might reduce the incentive for a utility to pursue some potential cost reductions, and customers therefore could be deprived of the benefit of such potential cost reductions in future rates.

Performance-based rate regulation, on the other hand, fosters a greater incentive for a utility to reduce costs. Customers benefit from such regulation to the extent they share in the cost reductions produced by the utility. Performance-based rates also shift the risk of cost increases more towards the utility and away from the customer. For example, if a utility were to experience increased costs under a traditional cost of service regime, it could file a rate case to recover all or a portion of such cost increases. Under performance-based rate regulation, however, customers are generally protected from such cost increases, and the utility bears the risk of increases during the period of the performance based rate plan. All of these reasons support the Legislature's finding in the Utility Restructuring Act that "it is in the public interest to promote competition in the electric industry and to establish performance-based ratemaking for regulated utilities;" R.I. G.L. § 39-1-1(d)(4), and demonstrate that a performance-based rate plan is more beneficial to customers than a traditional cost of service rate plan.

Prepared by or under the supervision of: Carlos A. Gavilondo

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-88

Request:

Is the Proposed Settlement more beneficial to ratepayers than the 2000 Settlement? Why or why not?

Response:

See the attached Letter and Memorandum for a summary of the benefits of the Settlement to Narragansett's customers. Since the letter and memorandum were filed with the Commission on June 23, 2004, Narragansett reduced its share of earnings to \$4.645 million. Narragansett believes that the benefits to customers summarized in the Letter and Memorandum are compelling, and represent a significant improvement over continuing the rates in place as they are today under the Current (2000) Settlement.

Prepared by or under the supervision of: Carlos A. Gavilondo



June 23, 2004

VIA HAND DELIVERY & ELECTRONIC MAIL

Luly E. Massaro, Commission Clerk
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, Rhode Island 02888

Re: The Narragansett Electric Company: Comprehensive Distribution Rate Settlement – Docket No.

Dear Ms. Massaro:

The Narragansett Electric Company (“Narragansett” or the “Company”) has reached a settlement in principle (“Settlement”) with the Division of Public Utilities and Carriers (“Division”), Department of the Attorney General (“Department”), the Economic Development Corporation (“EDC”), The Energy Council of Rhode Island (“TEC-RI”), and the United States Department of the Navy (“Navy”) (together, the “Parties”). The Settlement represents a comprehensive resolution of an array of issues pending before the Commission, and provides significant economic benefits to Narragansett’s customers. The Settlement:

1. Reduces Narragansett’s distribution service rates by \$10.243 million per year.
2. Freezes Narragansett’s distribution service rates at the lower level through December 31, 2009 – five additional years beyond the rate freeze currently in place (subject to exogenous changes and the phase-in for consolidated rates in point 9, below).
3. Reflects recovery of the low income credit expansion equal to an estimated \$2.6 million per year, avoiding an increase equal to that amount that would otherwise take place in the absence of the Settlement.
4. Confirms elimination of any rate increase associated with the expiration of Narragansett’s \$2.7 million per year settlement credit
5. Returns to customers over one year an estimated \$22.7 million of shared earnings accrued under Narragansett’s current rate plan.
6. Provides the cities of Providence and East Providence with an option to dedicate refunds to the undergrounding of the E-183 line.

7. Defers the recovery of Narragansett's voluntary early retirement offer made in 2003 and amortizes it over ten years commencing January 1, 2004
8. Maintains the increased level of contributions to the environmental response fund for the new rate freeze period, includes 280 Melrose Street in the sites eligible for remediation with the fund, and requires the net gains from the sale of designated sites to be credited to the fund.
9. Resolves all issues associated with Narragansett's rate design for the next five years, consolidates rate classes that have been previously closed with a phase-in that can extend as long as the new rate freeze period, and front loads the discount in Narragansett's low income rate encouraging customers to conserve.
10. Implements new standby service rate designs that meet the cost-based standards set forth in G. L. section 39-2-1.4 (a new law which becomes effective on January 1, 2005), reserves the rights of any party to contend that a further discount and/or credit meets the public interest under paragraph (c) of that statute, and implements a phase-in for customers currently served under Narragansett's Auxiliary Service rate.
11. Resolves disposition of deferred uplift charges by disallowing 25 percent of the deferred costs and amortizing the remainder over three years in Narragansett's transmission service cost adjustment.
12. Reduces the earned savings allowance in Narragansett's earnings reports from the filed "first look" allowance of \$8 million per year to \$5 million per year, and locks in the lower level through the remainder of the settlement period.
13. Continues the earnings sharing feature of the prior settlement, which gave rise to the \$22.7 million customer credit from the first rate freeze period.

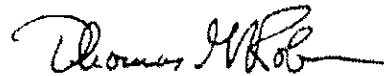
Under the Settlement, base distribution service rates for a typical residential customer using 500 kilowatt-hours per month will decrease by \$1.07. The Customer Credit will provide a further reduction of \$1.77, for the first twelve months after the Effective Date. These decreases are expected to significantly mitigate increases expected in the Standard Offer commodity prices as the result of higher fuel costs from our wholesale suppliers. The Settlement will become effective on the first cycle of the billing month following its approval by the Commission, even if that occurs before the end of this year. Except as noted in the Settlement itself, the agreement supercedes in its entirety the Third Amended Stipulation and Settlement that was approved by the Commission in Docket 2930, and has been in effect since May of 2000.

Luly E. Massaro, Commission Clerk
Rhode Island Public Utilities Commission
Comprehensive Distribution Rate Settlement
June 23, 2004
Page 3

The details of the Settlement are discussed in the attached Memorandum. The attached Exhibit 1 contains the calculation of the \$10.243 million rate reduction per year. Exhibit 2 to the Memorandum sets forth the calculation of the \$22.7 million customer shared earnings projected for December 31, 2004. The Parties are negotiating the final details of the Settlement and we anticipate filing the full Settlement together with all exhibits within a week.

Thank you for your attention to this filing. Please contact me at (508) 389-2877 or Laura Olton at (401) 784-7667 should you have any questions.

Very truly yours,



Laura S. Olton

Thomas G. Robinson
Laura S. Olton

Enclosures

cc: Settling Parties

**State of Rhode Island and Providence Plantations
Public Utilities Commission**

The Narragansett Electric Company) R.I.P.U.C. No.

Memorandum Describing Settlement

This Memorandum explains and supports the Settlement in principle (“Settlement”) reached by The Narragansett Electric Company (“Narragansett”) and the other Parties to the agreement – the Division of Public Utilities and Carriers (“Division”), Department of Attorney General (“Attorney General”), the Economic Development Corporation (“EDC”), The Energy Council of Rhode Island (“TEC-RI”), and the United States Department of the Navy (“Navy”) (together the “Parties”). The Settlement resolves an array of issues that are now or shortly would be pending before the Commission.

Background: the Third Amended Stipulation and Settlement

As part of Narragansett’s merger with the former Blackstone Valley Electric Company (“BVE”) and Newport Electric Corporation, (“Newport”) the Commission approved in Docket 2930 a long-term rate plan for Narragansett’s distribution rates. That rate plan was incorporated in the Third Amended Stipulation and Settlement. The distribution rates established in the Third Amended Stipulation and Settlement followed an extensive review of the distribution rates of the three merging companies, based on their costs prior to the merger. That rate settlement reduced the distribution service rates for BVE and Newport customers to Narragansett’s rate levels, and then decreased these rates further to reflect the customers’ portion of the estimated synergy savings and

efficiency gains following the merger. The lower rates were locked in for a five-year period, assuring that customers received their portion of the savings during that period.

Under the Third Amended Stipulation and Settlement, the acquisition costs and transaction costs associated with the merger were initially amortized over twenty years, the annual amortizations were expressly excluded from rates, and the unamortized balances were excluded from rate base (Third Amended Stipulation and Settlement, s. 7(A), p. 16). Rather than include these acquisition and transaction costs in rates, Narragansett was allowed to retain a portion of the estimated synergy savings and efficiency gains to offset them. The settlement was designed so that Narragansett could only realize this allowance if savings were actually achieved. Specifically, the Third Amended Stipulation and Settlement allowed Narragansett to retain a portion of the earnings actually realized during the period of the rate freeze in accordance with a specific formula. Narragansett's return on its earnings reports was adjusted by 1.5 percentage points from 10.5 percent to 12.0 percent, and shared thereafter to provide Narragansett with an opportunity to offset the costs of completing the merger. Thus, the approach guaranteed customers that they would receive their portion of the merger savings by directly reflecting the estimated savings in lower rates immediately, while Narragansett's ability to offset merger costs was tied directly to its ability to achieve savings.

The approach worked. Narragansett has reduced its costs over the five-year initial rate freeze period, the earnings sharing mechanism was triggered, and customers have accrued additional savings that are to be returned for their benefit.

1. Distribution Rate Reduction and Customer Credit

This Settlement implements the next steps contemplated by the Third Amended Stipulation and Settlement. It begins with a rate reduction. Under the Settlement, Narragansett has agreed to reduce distribution service rates by \$10.243 million per year and freeze those lower rates for the period through December 31, 2009. The rate reduction will become effective on the first cycle of the billing month after the Commission approves the Settlement, and does not need to await January 2005, the end of the Rate Freeze Period in the Third Amended Stipulation and Settlement. The calculation of the \$10.243 million rate reduction is presented in Exhibit 1 to this Memorandum. In addition, as part of the Settlement, Narragansett agrees to make permanent the settlement credit of \$2.7 million set forth in Section 2(c) of the Third Amended Stipulation and Settlement, and waives its right to increase rates to recover the expansion of the low income credits in Section 20 of the Third Amended Stipulation and Settlement, which has an estimated value of \$2.6 million per year.

Finally, Narragansett refunds to customers through a one year, reconciling Customer Credit, an estimated \$22.7 million associated with the customers' share of Narragansett's estimated earnings through December 31, 2004, adjusted for bonus tax depreciation (an exogenous factor associated with a change in the Federal Internal Revenue Code), service quality penalties, and accrued low income credits that are recoverable under the Third Amended Stipulation and Settlement. The calculation of the estimated customer shared earnings is set forth in Exhibit 2 to this Memorandum.¹ The

¹ The estimated amounts reflected in the Customer Credit will be reconciled to actual figures in a report filed with the Commission by May 1, 2005. That report will calculate the actual amount of earnings to be credited to customers, the amount of Service Quality Penalties, Bonus Tax Depreciation, and Low Income Expansion through December 31, 2004. As indicated in the Settlement, the Service Quality Penalties

estimated level of shared earnings of \$21 million (before the adjustments described above), shown on line 31 of that Exhibit, is predicated on deferring and amortizing the costs associated with the 2003 Voluntary Early Retirement Offer over 10 years, commencing on January 1, 2004.

The Customer Credit is designed to be returned to customers over the first twelve months after the Effective Date. However, the Parties have agreed upon an option for the cities of Providence and East Providence to apply the Customer Credit that would otherwise be provided to the residents and businesses in their communities to the costs of undergrounding the E-183 transmission line in accordance with the settlement approved by the Energy Facilities Siting Board in Docket SB-2003-1.

The rate reductions and the Customer Credit included in the Settlement provide significant value to Narragansett's customers. Over the next five years, customers will receive over \$50 million in rate reductions. The annual Settlement Credit of \$2.7 million implemented under the Third Amended Stipulation and Settlement will be made permanent. Customers will avoid paying increases in rates associated with the recovery of the Low Income discounts. Customers will also receive \$22.7 million in the first year from the Customer Credit. In short, customers will receive well over \$70 million of economic value under the Settlement. The result will be continued stable delivery rates for Narragansett's customers.

included in the \$22.7 million do not include any penalties that may accrue in 2004, and the Bonus Tax Depreciation and Low Income Expansion Costs, as well as the earnings themselves are estimates. The estimates will be updated to actuals in the May 1, 2005 report. In addition, the amounts actually refunded to customers through the Customer Credit will be reconciled to the amounts owing to customers in Narragansett's first annual reconciliation filing occurring after the expiration of the Customer Credit.

2. The Determination of Shared Savings and the Recalibration of the Earnings Sharing Calculation

The Settlement also establishes the savings to be shared between Narragansett and its customers at \$10 million total for the remainder of the Settlement Period, significantly below the \$15.8 million that Narragansett has proposed in Docket 2930. It continues the basic approach taken in the original settlement by providing the customers' share of savings up front and without risk in the form of lower rates immediately, and requiring Narragansett to continue to implement and maintain cost reduction and control measures in order to realize its portion of the shared savings. As shown on Exhibit 1 to this Memorandum, the \$10.243 million rate reduction is derived by first comparing Narragansett's 2005 projected revenues of \$230,847,000 to the benchmark cost of service of \$225,604,000 that is calculated using the formula established in the Third Amended Stipulation and Agreement, producing a difference of \$5,243,000. When the customers' \$5 million share of the savings is added to this amount, the agreed upon rate reduction of \$10.243 million per year included in the Settlement is produced. The customers receive their share of the savings whether or not Narragansett actually realizes its own share of those savings. Narragansett will only realize its \$5 million share of the savings if Narragansett actually achieves the lower costs.

In addition, the Settlement continues and recalibrates the shared earnings calculation. Rather than begin the earnings sharing at an average return on equity of 12.00 percent with none of Narragansett's saving share reflected in the analysis, the Settlement lowers the trigger point for sharing to 10.5 percent return on equity and includes Narragansett's \$5 million savings allowance as an expense in the underlying analysis. The Settlement also updates and lowers slightly Narragansett's cost of debt and

preferred stock using calendar year 2003 figures. The effect of these adjustments will allow earnings sharing triggers to begin at a lower level than under the Third Amended Stipulation and Settlement.

Finally, the Settlement treats the 2005 rate year reflected in the Settlement as the "Second Savings Verification" required under the Third Amended Stipulation and Settlement, and eliminates the need for a further savings verification that would otherwise have been required before 2007 in section 8(B), pages 20-21 of the Third Amended Stipulation and Settlement. This approach is consistent with the Third Amended Stipulation and Settlement that provides (at p. 21) that:

If the Company files a COS rate case in 2004 to change rates for usage on and after January 1, 2005 and such case would not otherwise trigger the "second Savings Verification", the Parties shall have the option to propose and the Commission shall have the authority to order that the "Second Savings Verification" take place in that proceeding.

As shown on Exhibit 1, customers have been fully credited with their \$5 million share of the savings in the rates that will be implemented under the Settlement. The Parties have agreed that this represents the "Second Savings Verification," and approval of the Settlement will eliminate the need for further proceedings in Docket 2930 with regard to the shared savings calculated in the first look, which is now pending before the Commission, and will eliminate the need for a second proceeding altogether.

3. Allocation of the Rate Reduction and Customer Credit and Agreement on Narragansett's Cost Allocation Among Rate Classes and Rate Consolidations

Pursuant to Section 23 of the Third Amended Stipulation and Settlement, Narragansett filed a revenue neutral allocated cost of service study with the Commission on June 7, 2004 in Docket 3610. The analysis in that Docket was based on calendar year

2003 deliveries and distribution revenues. It included several cost allocations that were subject to disagreement among the Parties. In the Settlement, the Parties have agreed that cost allocations now reflected in Narragansett's current rates are reasonable and can be maintained through the Rate Freeze Period. Moreover, the Parties have agreed to allocate both the distribution revenue reduction and the Customer Credit² among rate classes using an allocation that is based 50 percent on Narragansett's kilowatt-hour deliveries to each class and 50 percent on the distribution service revenues that Narragansett collects from each rate class. This approach represents a reasonable compromise among the representatives of the different customer classes, assures that all rate classes share in the decrease and Customer Credit, and fully resolves cost allocations among rate classes. As a result, no further rate design is required during the Rate Freeze Period in the Settlement.

In addition, the Parties have agreed to the rate simplifications and consolidations that Narragansett has proposed in Docket 3610. Narragansett will phase in any rate increases that may occur associated with the rate consolidations with annual adjustments based on the higher of five percent or one-fifth of the rate differential in current distribution service rates. This approach mitigates the increase, and allows the complete consolidation of rates by the end of the Rate Freeze Period. The percentage increases, when measured on a total bill basis, are significantly lower than the percentage increases measured on the distribution service rates alone. The specific classes that are being consolidated, and the increases associated with the phase-in on both a delivery and total bill basis will be provided as an exhibit to the Settlement.

² The Customer Credit to the Navy has been adjusted in accordance with the Settlement approved by the Commission in Docket 3551.

4. Standby and Supplemental Rates

The Settlement also resolves the design of Narragansett's standby and supplemental rates in Rates B-32 and B-62. Specifically, Narragansett has revised the rates to base the calculation of the distribution service billing demands to customers with on-site generation on the total customer use at the facility. Thus, Narragansett will meter both the generation at the facility and at its own delivery point and calculate the billing demand for distribution demand as the sum of the two metering points. Narragansett's distribution service rates will continue to include a 75 percent ratchet, which will be applied to the sum of the two meter readings. Narragansett will not assess any energy (i.e., kWh) charge on the backup portion of the service. In addition, Narragansett will not apply any transmission charges to the metered on-site generation. This approach recognizes the increased diversity of demands on the transmission system. Both the revenues and the distribution units associated with metered on-site generation will thus be eliminated from the reconciliations under Narragansett's Transmission Service Cost Adjustment Provision. The Parties agree that, with these modifications, Rates B-32 and B-62 fully comply with the requirements of G.L. § 39-2-1.4(a) and (b), and are cost-based, just and reasonable, and not unduly discriminatory under that statute. The Settlement also recognizes that the rate design was not based on the considerations set forth in paragraph (c) of the statute, and states that nothing in the Settlement precludes a customer from requesting a discounted rate and/or credits under G.L. § 39-2-1.4(c), or prevents any party from opposing such a request.

Finally, the Parties have agreed to a phase-in of Narragansett's Auxiliary Service customers to the applicable back-up service rate. This phase-in will occur over the five-year Rate Freeze Period commencing on January 1, 2005 to comply with G.L. § 39-2-1.4.

5. Expansion of the Environmental Response Fund

The Parties have agreed to allow Narragansett to expand the scope of the Environmental Response Fund to include additional properties beyond those included in the Third Amended Stipulation and Settlement, and Narragansett has agreed to expand the resources available to the Fund by eliminating the potential for reduced funding under the contingency reserved in Docket 2930, and by including net gains on the sales of property that may be cleaned up using the resources from the Environmental Response Fund. Specifically, Narragansett has expanded the definition of Environmental Response Costs to include materials other than manufactured gas wastes, and included its 280 Melrose Street facility in the list of sites. Narragansett has agreed to credit the fund with the net gain that it may realize on the sale of 280 Melrose Street, or any other property that has been remediated using the Environmental Response Fund.

6. Deferred Uplift Costs

Narragansett has deferred recovery of approximately \$7.4 million of uplift costs as a result of an ongoing dispute with its standard offer service suppliers. Narragansett filed a statement of facts associated with these costs with the Commission on June 18, 2004, and the facts will not be repeated here. The Settlement resolves all issues with the recovery of these costs by disallowing 25 percent and allowing recovery of the remaining \$5.6 million over the next three years in Narragansett's Transmission Service Cost Reconciliation. In addition, the Parties agree that Narragansett shall be allowed to

recover all ongoing uplift costs through their inclusion in Narragansett's Transmission Service Reconciliation.

7. Service Quality Performance Standards

One set of issues that Parties have not fully resolved relates to the Service Quality Performance Standards set forth in the Settlement. As the result of time limitations, the Parties were unable to reach an accord on the specifics of these Standards over the Rate Freeze Period. As a result, the Parties have agreed that the review planned to commence in August 2004 should continue. However, to assure that the economic value in the Settlement is maintained, the Parties agreed that the review shall not change the maximum penalty that can be assessed under today's plan, the offsetting of penalties shall continue, and the Standards will continue to be calibrated based on historical performance.

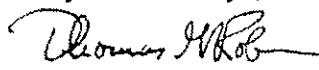
Conclusion

The Settlement provides significant economic value to Narragansett's customers and resolves an array of issues facing Narragansett and the Commission in a reasonable and consensual manner. The Settlement and the tariffs attached to the Settlement will be filed next week with the Commission.

Respectfully submitted,

**THE NARRAGANSETT ELECTRIC
COMPANY**

By its Attorneys,


Laura S. Olton

Thomas G. Robinson
Laura S. Olton

NARRAGANSETT ELECTRIC COMPANY
CALCULATION OF CUSTOMER/COMPANY SHARED SAVINGS
(\$000)

<u>Line</u>	<u>Amount</u>
1 Forecasted Revenue - 2005	\$230,847
2 Cost of Service supporting Total Savings to be Shared	\$215,604
3 Forecasted Benchmark COS 2005	\$225,604
4 Total Savings to be Shared	\$10,000
5 Customer Share of Total Savings	<u>\$5,000</u>
6 Company Share of Total Savings	\$5,000
7 Cost of Service Including Shared Savings	\$220,604
8 Distribution Rate Decrease	<u>\$10,243</u>

Line Notes

- 1 Proforma distribution revenues under current rates with elimination of hold harmless provisions.
- 2 Distribution Cost of Service to support \$10 million of total savings from adjusted benchmark Cost of Service for 2005
- 3 Page 2 of 2
- 4 Line 3 minus Line 2
- 5 Line 4 times 50%
- 6 Line 4 minus Line 5
- 7 Line 2 plus Line 6
- 8 Line 1 minus Line 7

NARRAGANSETT ELECTRIC COMPANY

CALCULATION OF ADJUSTED BENCHMARK COST OF SERVICE - 2005

						<u>Amount</u>
1	Benchmark Cost of Service					\$210,000 (a)
2	GDPIPD Growth 2001 - Actual	2.36%	(b) *	50% + 1		<u>1,0118</u>
3	2001 Adjusted Benchmark COS					\$212,478
4	GDPIPD Growth 2002 - Actual	1.13%	(b) *	50% + 1		<u>1,0057</u>
5	2002 Adjusted Benchmark COS					\$213,679
6	GDPIPD Growth 2003 - Estimated	1.67%	(c) *	50% + 1		<u>1,0084</u>
7	2003 Adjusted Benchmark COS					\$215,463
8	GDPIPD Growth 2004 - Estimated	1.70%	(c) *	50% + 1		<u>1,0085</u>
9	2004 Adjusted Benchmark COS					\$217,294
10	GDPIPD Growth 2005 - Estimated	1.33%	(c) *	50% + 1		<u>1,0067</u>
11	2005 Adjusted Benchmark COS					\$218,739
12						
13	2000 kWh Sales from Settlement					7,098,202,000 (a)
14						
15	Weather Normalized Sales Growth - 2005 - Est					<u>7,840,717,000 (d)</u>
16						
17	Adjusted Sales Growth	10.46%	*	30% *		\$218,739 <u>\$6,864</u>
18						
19	Adjusted Benchmark Cost of Service - 2005					<u>\$225,604</u>

Notes

- (a) Per Third Amended Stipulation and Settlement dated March 14, 2000.
- (b) Per Earned Savings Proof filing dated June 27, 2003
- (c) Forecasted inflation rates obtained from Company subscription services with Economy.com
- (d) Company forecasted weather normalized kWh sales for 2005

NARRAGANSETT ELECTRIC COMPANY

CALCULATION OF ESTIMATED CUSTOMER SHARED EARNINGS AT DECEMBER 31, 2004
(\$000)

<u>Line</u>					
1	Actual Intrastate Earnings Available for Common - CY 2000	\$26,870	(a)		
2	Actual Intrastate Earnings Available for Common - CY 2001	\$35,077	(b)		
3	Actual Intrastate Earnings Available for Common - CY 2002	\$41,576	(c)		
4	Actual Intrastate Earnings Available for Common - CY 2003	\$34,937	(d)		
5	Estimated Intrastate Earnings Available for Common - CY 2004	<u>\$34,105</u>	(e)		
6					
7	Annual Average			\$34,513	
8					
9	Actual Average Common Equity - 2000	\$226,307	(a)		
10	Actual Average Common Equity - 2001	\$250,787	(b)		
11	Actual Average Common Equity - 2002	\$255,258	(c)		
12	Actual Average Common Equity - 2003	\$258,493	(d)		
13	Estimated Average Common Equity - 2004	\$260,719	(e)		
14					
15	Five Year Average			<u>\$250,313</u>	
16					Customer
17	Average Annual Return			<u>13.79%</u>	<u>Share</u>
18					
19	ROE in 50%/50% Bandwith (>12.00%, <13.00%)			1.00% * 50.00%	= 0.50%
20	ROE in 75%/25% Bandwith (>13.00%)			0.79% * 75.00%	= <u>0.59%</u>
21					
22	Total Customer ROE Sharing				1.09%
23	Annual Average Equity				<u>\$250,313</u>
24					
25	Average Annual Customer Shared Earnings				\$2,735
26	Tax Gross-up				<u>/ 65.00%</u>
27					
28	Average Annual Customer Shared Earnings - Pre-tax				4,207
29	Number of Years				<u>x 5</u>
30					
31	Total Customer Shared Earnings 1/1/2000 - 12/31/2004				\$21,036
32					
33	Accrued Service Quality Penalties to Date				\$1,744 (f)
34	Company Share of Incremental Low Income Expansion 2000 - 2004 (25%)	5,280	*	25.00%	= (\$1,320)
35	Bonus Tax Depreciation Revenue Requirement Benefit - 2004				<u>\$1,279</u>
36					
37	Total Net Customer Shared Earnings to be Refunded				<u>\$22,739</u>

- (a) December 31, 2000 Earnings Report - Revision 2 submitted February 28, 2003
- (b) December 31, 2001 Earnings Report - Revised submitted February 28, 2003
- (c) December 31, 2002 Earnings Report - Revised submitted February 12, 2004
- (d) December 31, 2003 Earnings Report adjusted to exclude the impact of the 2003 VERO charge.
- (e) Company estimate for 2004.
- (f) Accrued Service Quality Penalties through December 31, 2003 pursuant to current Service Quality Performance Standards

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-89

Request:

Other than certainty to the parties of entering into a settlement prior to filing testimony, why is the Proposed Settlement inherently more beneficial to ratepayers than a fully litigated rate case?

Response:

The Parties likely had different reasons for entering into the proposed Settlement, however, it is reasonable to assume that each party concluded that the aggregate benefits provided by the Settlement to the settling party (or their constituents), and the corresponding certainty of those benefits in a settlement context, were superior to an uncertain litigated outcome. The settling parties expressed a variety of litigation positions on several matters resolved in the settlement, and the settlement represents a compromise of those various positions in a manner that all parties found acceptable. Further, the Settlement reasonably resolves a number of issues that might not be as comprehensively or satisfactorily resolved in the context of a fully litigated rate case.

Prepared by or under the supervision of: Legal Department

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's First Set of Data Requests

Commission Data Request 1-90

Request:

Based on the rates filed in the proposed Settlement, what is Narragansett's revenue requirement? Indicate what Narragansett Electric's revenue requirement was for 2003 and is estimated to be for 2004.

Response:

The attached schedules provide a derivation of the Company's intrastate cost of service for 2003. The 2003 cost of service of \$216,278,000 was based on the Company's December 2003 Earnings Report adjusted to eliminate the 2003 VERO charge of \$25,122,000. Also, the imputed capital structure and rates, as provided for in the 2000 Settlement, were used in arriving at this 2003 revenue requirement.

The Company has not performed a cost of service revenue requirement for calendar year 2004. A preliminary cost of service for 2005 however was prepared and is included with the response to Commission Data Request 1-91.

Prepared by or under the supervision of: Michael D. Laflamme

Narragansett Electric Company
2003 Intrastate Cost of Service
(\$ in thousands)

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's Data Requests – 1-90
Page 1 of 2

Total Operating Expenses	\$711,258
Less: Purchased Power Expense	469,398
Transmission Wheeling	42,641
C&LM	16,799
Gross Receipts Tax	<u>28,129</u>
Net Operating Expenses	154,291
Pre-tax Return on Rate Base	<u>61,987</u>
2003 Intrastate Cost of Service	<u>\$216,278</u>

Actual Average Intrastate Rate Base - 2003	\$516,986
2000 Settlement Pre-tax Return on Rate Base	<u>11.99%</u>
2003 Pre-tax return on Rate Base	\$61,987

THE NARRAGANSETT ELECTRIC COMPANY
RETURN ON EQUITY CALCULATION
Twelve Months Ended December 31, 2003
Adjusted to Exclude 2003 VERO Charge

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation & Settlement
Response to Commission's Data Requests – 1-90
Page 2 of 2

Line No.	A	TOTAL COMPANY B	INTERSTATE AMOUNT C	INTRASTATE AMOUNT PER SCHEDULES D	Adjust to Eliminate 2003 VERO	Adjusted 2003 Intrastate earnings
1	Revenue - Sales of Electricity	\$397,687	\$0	\$397,687		397,687
2	Other Revenue	<u>382,249</u>	0	<u>387,068</u> 1/		<u>387,068</u>
3	Total Revenue	<u>\$779,936</u>	\$0	<u>\$784,755</u>		<u>\$784,755</u>
4	Operating Expenses:					
5	Purchased Power	469,398	0	469,398		469,398
6	Fuel	0	0	0		0
7	Production O&M	94	0	94		94
8	Transmission Wheeling	42,641	0	42,641		42,641
9	Genl & Admin. O&M	77,416 2/	2,358	75,058 2/	(24,356) 8/	50,702
10	All Other O&M, Including C&LM	43,003	395	65,365 3/		65,365
11	Amortization of Goodwill	0	0	0 4/		0
12	Depreciation	36,742	3,741	33,001		33,001
13	Amort. - Loss on Reaq. Debt	---	103	609 5/		609
14	Amortization - Other	295	0	295		295
15	Gross Earnings Tax	28,129	0	28,129		28,129
16	Municipal Tax	20,274	3,141	17,133		17,133
17	Other Taxes	3,917	113	3,804		3,804
18	Current and Deferred Income Taxes	17,302			7/	0
19	Amortization of ITC	(717)	0	(717)		(717)
20	(Gain)/Loss on Disposition of Utility Plant	0	0	0		0
21	Interest on Cust. Deposits	---	0	127 6/		127
22	Donations	---	21	677 6/		677
23	Total Operating Expenses	738,494		<u>735,614</u>		<u>711,258</u>
24	Net Operating Income	\$41,442				
25	Intrastate Operating Income Before Taxes			49,141		73,497

NOTES:

1/ Excludes excess earnings accrual of \$4819 for the 12 month period.

2/ Includes a 2003 VERO charge totaling \$25.1 million.

3/ Excludes G&T credit of \$-27337, Advertising exp.(account 930.1) of \$89, Membership Dues of \$88 and \$395 of other O&M.

Also excludes incremental NIMO intergration costs of \$4082. Includes 100% of C&LM expenses and an adjustment of \$-320 to normalize uncollectible accounts expense to actual net write-offs. Also excludes \$-0 of out-of-period environ. resp. funding adj.

4/ Goodwill and related amortization is eliminated from the ROE calculation.

Effective Sept. 2000, Goodwill Amortization reclassified to Below the Line, Other Income and Deductions.

5/ Held at Merger Settlement COS amount of \$712k due to fixing Capital Structure and Rates.

6/ Below the line items brought above the line for ratemaking.

7/ Calculated using imputed capital structure and cost rates in Docket 2930 settlement agreement.

8/ Total 2003 VERO charge of 25,122 times 96.95% intrastate portion