



December 29, 2004

VIA HAND DELIVERY & ELECTRONIC MAIL

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

**RE: Docket 3617 – Distribution Rate Plan Stipulation and Settlement
Exogenous Events Filing**

Dear Ms. Massaro:

Pursuant to Section 2(C)(1) of the Distribution Rate Plan, Second Amended Stipulation and Settlement dated October 15, 2004 approved by the Commission in Docket 3617 (the “2004 Settlement”), The Narragansett Electric Company (“Narragansett” or the “Company”) shall file for adjustments related to Exogenous Events no later than December 31st of the year in which the Exogenous Event has occurred. The Company is hereby notifying the Commission of two events which changed Narragansett’s revenue requirement by amounts in excess of the Exogenous Event thresholds set forth in the 2004 Settlement. Ten copies of this letter are enclosed.

Section 2(B)(2) of the 2004 Settlement provides as follows:

Federally Initiated Cost Change: Narragansett shall adjust its distribution rates (upward or downward) if the occurrence of a “Federally Initiated Cost Change”, as defined below, causes (in the aggregate) a change in Narragansett’s revenue requirement by more than \$750,000. For purposes of this Settlement, the term “Federally Initiated Cost Change” shall mean:

- (i) any externally imposed changes in the federal tax rates, laws, regulations, or precedents governing income, revenue, or sales taxes or any changes in federally imposed fees; and
- (ii) any federal legislative or federal regulatory mandates which impose new obligations, duties or undertakings, or remove existing obligations, duties, or undertakings which individually decrease or increase Narragansett’s costs, revenue, or revenue requirement.

The two Exogenous Events identified as having been triggered in 2004 are:

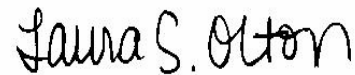
1. The Job Creation and Worker Assistance Act of 2002, signed into law in March of 2002, amended the Internal Revenue Code Section 168 by adding a subsection (k) - Special Allowance for Certain Property Acquired After September 10, 2001 and Before September 11, 2004 ("IRC 168(k)"). IRC 168(k) provides for additional first year tax depreciation deductions for certain qualified property ("Bonus Depreciation"). IRC 168(k), as initially enacted, provided for an additional 30% first year tax depreciation deduction for qualified property in addition to the first year tax deduction pursuant to the Modified Accelerated Cost Recovery System ("MACRS") on the remaining 70% of that property. In 2003, the first-year bonus depreciation was further increased from 30% to 50% for qualifying property placed in-service after May 5, 2003 and through December 31, 2004. Because the Company fully normalizes for differences in book and tax depreciation rates, IRC 168(k) gives rise to additional deferred taxes, which in turn reduces the Company's rate base and revenue requirement. During calendar year 2004, IRC 168(k) reduced the Company's revenue requirement by an estimated \$1.2 million (see Exhibit 8, pages 5 through 11 of the 2004 Settlement). This estimate was included with amounts currently being refunded to customers via the 2004 Settlement's Customer Credit over the twelve-month period beginning November 1, 2004.
2. The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Medicare Act of 2003") was signed into law in December 2003 and became effective on July 1, 2004. The Medicare Act of 2003 introduces a new Medicare Part D – prescription drug benefit, beginning in 2006 and provides for, among other things, potential federal subsidies to employers that provide retiree prescription drug coverage, if the coverage is at least actuarially equivalent to the standard Medicare Part D prescription drug benefits. In addition, federal subsidies received pursuant to the Medicare Act of 2003 are tax-free. The provisions of the Medicare Act of 2003 generated a decrease in Narragansett's actuarially determined expense for 'post-retirement benefits other than pensions' pursuant to FAS106, and when combined with the added tax benefits of the anticipated tax free subsidies, generated a reduction in the Company's revenue requirement in 2004 by an estimated \$1.1 million. Please see the attached schedule for a calculation of the estimated 2004 revenue requirement impact of the Medicare Act of 2003.

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At the time of approval of the 2004 Settlement, the impact of the Medicare Act of 2003 was still being determined and consequently an estimate was not included in the 2004 Settlement Customer Credit. The Company had indicated that if the Medicare Act of 2003 qualified as an Exogenous Event for 2004, the Company would include such amount in its reconciliation of the Customer Credit in May 2005. A true-up of the Bonus Depreciation benefit for 2004 along with the actual 2004 benefit of the Medicare Act of 2003 will be included in the final reconciliation of the Customer Credit in May 2005.

Thank you for your attention to this matter. If you have any questions regarding this transmittal, please feel free to contact me at (401) 784-7667.

Very truly yours,

A handwritten signature in black ink that reads "Laura S. Olton". The script is cursive and fluid.

Laura S. Olton

Enclosures

cc: Docket 3617 Service List

Narragansett Electric Company
Estimated Benefit of Medicare Act of 2003
July 1, 2004 - December 31, 2004

	<u>Narragansett</u>	<u>NGUSA Service Company</u>	<u>Total</u>
Estimated July 1, 2004 through December 31, 2004 FAS106 Expense Before Medicare Act of 2003	4,890,584	7,671,698	
Estimated July 1, 2004 through December 31, 2004 FAS106 Expense After Medicare Act of 2003	<u>4,029,282</u>	<u>6,232,976</u>	
Estimated Annualized Difference	861,302	1,438,723	
Estimated Allocation Percentage Charged to Narragansett	<u>N/A</u>	<u>15.00%</u>	
Estimated Gross Narragansett Benefit	861,302	215,808	
Estimated capitalized percentage	<u>40.00%</u>	<u>23.00%</u>	
Estimated Capitalized amount	(344,521)	(49,636)	
Estimated Net O&M Expense Benefit	516,781	166,172	682,954
Estimated tax Gross-up			<u>/ 65%</u>
Total Estimated Medicare Act of 2003 benefit for Calendar Year 2004			<u><u>1,050,698</u></u>

Certificate of Service

I hereby certify on the 29th day of December 2004, that a copy of the cover letter and / or any materials accompanying this certificate has been mailed or hand-delivered to the parties listed below.



Joanne M. Scanlon
The Narragansett Electric Company

Narragansett Electric Company – Distribution Rate Plan Stipulation & Settlement – Docket 3617 - Service List as of 09/14/04

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