Narragansett Electric
A National Grid Company

Thomas G. Robinson
Deputy General Counsel

September 15, 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
Pre-filed Direct Testimony

Dear Ms. Massaro:

Enclosed on behalf of Narragansett Electric Company (the "Company") please find ten copies of pre-filed direct testimony of Carlos A. Gavilondo, Jeanne A. Lloyd and Michael D. Laflamme in support of the Settlement in the above-captioned proceeding. The Company anticipates filing an Amended Settlement on September 17, 2004 in accordance with the procedural schedule.

Thank you for your attention to this matter. Please feel free to contact me if you have any questions regarding this transmittal.

Very truly yours,

Thomas G. Robinson

Enclosures

cc: Docket 3617 Service List

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The Narragansett Electric Company

Distribution Rate Plan
Stipulation and Settlement

Testimony and Exhibits of:
Carlos A. Gavilondo
Michael D. Laflamme
Jeanne A. Lloyd

September 15, 2004

Submitted to:
Rhode Island Public Utilities Commission
R.I.P.U.C. Docket No. 3617

Submitted by:

Narragansett Electric
A National Grid Company

Testimony of
Carlos A. Gavilondo

DIRECT TESTIMONY

OF

CARLOS A. GAVILONDO

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I. Introduction and Qualifications

Q. Please state your full name and business address.

A. Carlos A. Gavilondo, 55 Bearfoot Road, Northborough, Massachusetts 01532.

Q. What is your position?

A. I am Vice President, Distribution Regulatory Services, for The Narragansett Electric Company ("Narragansett" or "the Company"). In that capacity, I am responsible for the Company's distribution rates and regulatory support groups.

Q. Please describe your educational background and training?

A. I received my bachelor of science in electrical engineering in 1985 from Tulane University in New Orleans, Louisiana. I received my law degree from Tulane Law School in 1993.

Q. What is your professional background?

A. From 1985 to 1990, I worked as an electrical design engineer and product specialist for Westinghouse Electric Corporation, in their Power Generation Business Unit. In 1993, following my graduation from law school, I worked for one year as a federal judicial law clerk in New Orleans. I then joined the law firm of Squire, Sanders and Dempsey, in Phoenix, Arizona, where I worked from 1994 to 1996 practicing environmental law. In 1996, I joined the legal department of New England Electric System, the predecessor of National Grid USA, where I worked on state and federal regulatory matters. In August 2001, I took the position of General Counsel for Silica Networks, S.A., a long-haul fiber optic telecommunication company based in Santiago, Chile, that was partly owned by a subsidiary of National Grid plc. As a result of National Grid's decision to exit the telecommunications business in Chile and Argentina, I moved back to Massachusetts in March of 2002, and assumed my present position in April 2002.

II. **Purpose of Testimony**

Q. What is the purpose of your testimony?

A. In my testimony, I describe the Distribution Rate Plan Stipulation and Settlement filed in this docket on June 29, 2004 ("Settlement"). In addition, as a result of the extensive written discovery in this proceeding, the open meetings held on August 19 and September 10, the formal technical session held September 1, and the public hearings conducted in Pawtucket, Warwick and East Providence, the Company and the other settling parties have agreed upon several proposed amendments to the original Settlement. My testimony describes these various proposed amendments and how they would modify the Settlement as filed.

Q. Are any other Company witnesses filing testimony in support of the Settlement?

A. Yes. In addition to my testimony, the Company is presenting the pre-filed testimony of Mr. Michael D. Laflamme, Manager of Regulatory Support for Narragansett, and Ms. Jeanne A. Lloyd, Principal Analyst for Narragansett.

Q. How is your testimony organized?

A. I first provide a brief overview of the Settlement filed in this case. I then describe the Settlement and its specific provisions in more detail. Next I describe several amendments to the Settlement that have been agreed to by the Parties. Finally, I provide an update on on-going discussions with other parties and intervenors regarding the Settlement.

III. <u>Description of Settlement</u>

A. <u>Overview of Settlement</u>

Q. Who are the parties to the Settlement?

A. In addition to Narragansett, the other parties to the Settlement include the Division of Public Utilities and Carriers ("Division"), Department of Attorney General ("Attorney General"), The Energy Council of Rhode Island ("TEC-RI"), and the United States Department of the Navy ("Navy") (together the "Parties"). Although not formally a party, the Economic Development Corporation ("EDC") also has indicated its support for the Settlement.

Q. Why is the Company proposing a new Settlement at this time?

A. In Docket No. 2930, the Commission approved the Third Amended Stipulation and Settlement rate plan settlement ("2930 Settlement"). The 2930 Settlement established a merger rate plan in connection with the 2000 merger of Narragansett with the former Blackstone Valley Electric Company ("BVE") and the former Newport Electric Corporation ("Newport"). The initial rate freeze period under the 2930 Settlement is scheduled to expire at the end of this year. The Settlement proposed in this Docket is intended to address the expiration of the rate freeze in the 2930 Settlement, as well as solidify the benefits created under that settlement, and address several other issues currently pending before the Commission.

Q. Please provide an overview of the Settlement.

A. The Settlement in this case provides for a base distribution rate reduction of $10.243 million from 2005 rate year revenues. These reduced distribution rates are proposed to become effective as soon the first billing cycle of October 2004, and would be frozen through December 31, 2009, subject to adjustment only for certain defined “exogenous” events. As part of this Settlement, the Company also waives any claim it might have to try to end the current settlement credit established under the 2930 Settlement, and waives its right to increase rates to recover the incremental cost of the low-income rate expansion authorized under the 2930 Settlement.

The Settlement also provides for elimination of several older rate classes, and the consolidation of the customers served under those rate classes to the Company’s other tariffed rate classes. This change will allow the Company to eliminate several outdated and closed rates, which will simplify tariff administration and reduce the extent of cross-subsidies that might have existed under the older rates. To mitigate the customer impact that termination of some of the old rates may cause, the Company has proposed that some rates be "phased out," rather than ended immediately. In addition, the Company has proposed redesigns of its current back-up service rates and its low-income rate to respond to suggestions and recommendations raised with respect to these rate designs during the past few years.

Under the Settlement, the shared savings the Company would be permitted to reflect in its cost of service is set at $4.645 million. This amount is substantially less than what the Company filed for in Docket No. 2930, and represents the maximum amount the Company would be allowed to reflect in any future cost of service studies and earnings calculations going forward. The Company's ability to continue to reflect this shared savings amount in the period between 2010 and 2019 would be subject to the reopener protections in the Settlement.

The earning sharing mechanism that was established in the 2930 Settlement also would continue under this Settlement. Under the Settlement, Narragansett would have an imputed capital structure of 50 percent equity, 45 percent debt, and 5 percent preferred equity, with an authorized return on equity ("ROE") of 10.5 percent. Accumulated earnings up to and including 100 basis points above the authorized ROE (i.e., up to and including 11.5 percent), would be shared 50/50 between customers and the Company. Earnings over 11.5 percent would be allocated 75 percent to customers and 25 percent to the Company.

The Settlement also addresses the issue of accumulated shared earnings under the 2930 Settlement by resolving matters that could affect the cumulative shared earnings amount under the 2930 Settlement (e.g., treatment of the 2003 voluntary early retirement offer ("VERO") costs, disallowed uplift costs), setting forth how the amount is to be calculated, the basis for allocating the accumulated shared earnings among customer classes, and proposing a Customer Credit provision designed to return the amount to customers over twelve months. The Settlement is also designed to facilitate the option available to the cities of Providence and East Providence under G.L. 42-98-1.1 to direct some or all of the respective Customer Credit refunds that would otherwise go to customers in those cities towards the costs of placing the E-183 transmission line in those cities underground.

With respect to the uplift cost recovery request pending in Docket No. 3616, the Settlement resolves it by requiring Narragansett to write-off 25 percent of the $7.45 million amount deferred by the Company, and to recover the remaining amount over three years pursuant to the Company's Transmission Service Cost Adjustment provision. So as not to affect the accumulated shared earnings amount, the Settlement also provides that the 25 percent amount disallowed for recovery would also be disallowed for earnings report purposes.

B. Settlement Details

1. Background -- 2930 Settlement

Q. Please provide a brief description of the 2930 Settlement.

A. With the merger of Narragansett, BVE and Newport, the operations of the three companies were combined, and customers of BVE and Newport were transferred, to the greatest extent possible onto Narragansett's rates effective May 1, 2000. Under the 2930 Settlement, Narragansett implemented a $13.1 million revenue reduction and froze rates at this reduced level from May 1, 2000 through December 31, 2004.

Under the 2930 Settlement, acquisition and transaction costs associated with the merger were expressly excluded from rates, and the unamortized balances were excluded from rate base. The Settlement also included an incentive-based merger savings plan which allowed Narragansett to retain a portion of the estimated efficiency gains from the merger. The 2930 Settlement was designed so that Narragansett could only realize this incentive if savings were actually achieved. That is, Narragansett's allowed return on equity for earnings report purposes was adjusted by 1.5 percentage points from 10.5 percent to 12.0 percent, and incremental earnings above 12 percent were to be shared between customers and Narragansett. This approach guaranteed customers would receive their portion of projected merger savings by directly reflecting the estimated savings in lower rates immediately, while Narragansett was incented to maximize efficiencies through a sharing of incremental earnings.

In addition to the earnings sharing mechanism, the 2930 Settlement established an incentive mechanism for creating long-term efficiency savings, and provided a mechanism for measuring such savings and reflecting them in rates going forward. The Company's proposal to determine these efficiency savings was originally filed June 27, 2003, and has been the subject of extensive discovery and proceedings before the Commission, where it is still pending.

The 2930 Settlement also provided for the establishment of an Environmental Response Fund for the clean-up of certain contaminated sites previously associated with manufactured gas plants or their waste, established a Service Quality performance plan, expanded the eligibility and funding for Narragansett's low-income rate class, and set the annual funding level and mechanism for funding the Company's Storm Fund. The 2930 Settlement also required that if by June 1, 2004 the Company had not made a cost of service rate case filing to change rates for usage on and after January 1, 2005, that it would be required to make a revenue neutral rate redesign filing no later than June 1, 2004 for rates effective January 1, 2005. The Company made its revenue neutral rate design filing on June 7, 2004, and the Commission established Docket No. 3610 to review that filing.

The rate freeze period under the 2930 Settlement ends December 31, 2004. However, no cost of service rate change is required under that settlement or would occur for the period after January 1, 2005 absent the filing of a rate case by Narragansett to increase rates, the filing of a complaint by the Division or another party to reduce rates, or the initiation of a rate investigation by the Commission on its own motion.

The proposed Settlement in this case provides, in effect, an extension of many of the beneficial elements established under the 2930 Settlement. However, the new Settlement provides more customer benefits than would necessarily result under the 2930 Settlement, and resolves a number of contested, or potentially contested, issues related to that settlement.

2. Proposed Settlement

Distribution Rate Reduction

Q. How would the proposed $10.243 million distribution rate decrease be implemented?

A. Under the Settlement, Narragansett would implement a base distribution rate reduction of $10.243 million per year from rates currently in place. This rate reduction would be implemented during the billing month of October 2004, which is three months prior to the expiration of the rate freeze under the 2930

Settlement. Thus, customers not only would see guaranteed lower rates under the Settlement, they would see them much sooner than provided for under the 2930 Settlement. The proposed distribution rate reduction of $10.243 million is in addition to the $13.1 million revenue reduction already provided under the 2930 Settlement. The calculation of the distribution rate reduction is set forth in Exhibit 1 to the Settlement filing.

Q. How do the proposed rate levels in this Settlement compare to the Company's prior distribution rate level?

A. The rate levels proposed in the Settlement are lower than they are currently. Attached as Exhibit CAG-1 to my testimony is a graph comparing the per kWh rates of the Company from 1997 through the end of the proposed rate freeze in this Settlement.

Q. How would the distribution rate reduction be allocated among rate classes?

A. The proposed allocation of the distribution rate reduction among rate classes is shown in Exhibit 3 to the Settlement. As indicated there, the rate reduction is allocated to rate classes based 50 percent on the respective rate class's kWh deliveries, and 50 percent on the distribution revenues from the rate class.

Q. Is the settlement credit from the 2930 Settlement or the low income expansion cost recovery reflected in the proposed rate reduction?

A As the Company noted in its response to Commission Data Request 4-2 in this Docket, the proposed $10.243 million distribution rate reduction is in addition to any value associated with making permanent the settlement credit from the 2930 Settlement, or any value to customers from the Company forgoing the right to increase rates to recover the incremental lost revenue associated with the low income expansion authorized in the 2930 Settlement.

The $13.1 million rate reduction provided under the 2930 Settlement included an initial settlement credit amount of $2.7 million. Under the 2930 Settlement, in the event the Company's demonstrated return on equity in 2003 was below 10.5 percent, the Company would be authorized to terminate the settlement credit at the end of the 2930 Settlement rate freeze period. Under the Settlement in this case, the parties have agreed that the settlement credit established in the 2930 Settlement shall be made permanent, and that Narragansett would waive any rights it has or may have had to argue that the conditions for terminating the settlement credit were met.

As part of the 2930 Settlement, Narragansett expanded the eligibility provisions of its low income discount rate (Rate A-60) to include all customers eligible for the state's low income home energy assistance program ("LIHEAP"). The incremental lost revenue associated with this expansion is estimated to total approximately $2.6 million in 2005. Under the 2930 Settlement, Narragansett was authorized to track the lost revenue of such expansion, and to include the incremental lost revenue of the expansion for recovery as part of a reconciling adjustment factor until the Company's first rate case, and to roll such additional amount into distribution rates after the 2930 Settlement rate freeze. As part of the Settlement in this case, the Company has agreed not to seek any additional rate recovery in connection with the low income program expansion going forward.

Distribution Rate Freeze and Exogenous Events

Q. Describe the proposed distribution rate freeze

A. The Settlement provides for a rate freeze at the new, reduced rates from the billing month of October 2004 through December 31, 2009. During the rate freeze period, distribution rates would be subject to adjustment -- up or down -- only as the result of pre-defined exogenous events. These exogenous event provisions, which are described in Section 2 of the Settlement (pp. 3-5), are essentially the same exogenous event provisions that were included in the 2930 Settlement, and include: State Initiated Cost Changes; Federally Initiated Cost Changes; Regulatory Cost Reallocations; and Excessive Inflation. Similar to the allocation of the proposed base distribution rate reduction, any exogenous factor that might be implemented under the Settlement would be allocated among rate classes based 50 percent on kWh deliveries and 50 percent on distribution service revenues.

The Company would make annual filings indicating whether an exogenous event has occurred in the preceding year, and any other party can also make such a filing if it disagrees with the Company's determination. Any exogenous factor recovery or credit would be subject to Commission approval. As is the case in the 2930 Settlement, the Company's ability to seek rate recovery for any qualifying exogenous event would be subject to the Company's earnings being less than the allowed return on equity of 10.5 percent.

Notwithstanding the rate freeze, however, Narragansett would not be precluded during the period of the rate freeze from proposing increases in other "non-rate" fees or charges, such as line extension charges or pole attachment fees. Nor would the Company be precluded from proposing new services to customers or non-regulated power producers for fees, provided that such fees are subject to Commission approval. Following the rate freeze, distribution rate changes could be proposed pursuant to traditional cost of service ratemaking.

<u>Rate Consolidation and Redesign</u>

Q. The Settlement includes the elimination of several current rate classes and the redesign of some other rates. Could you please elaborate on this?

A. As part of the Settlement, the parties agreed to the elimination of several closed and/or outdated rate classes, and the consolidation of customers from those rate classes to rate classes that have the effect of treating similarly situated customers comparably. To mitigate the impact that termination of some of these old rates might have on customers, the Settlement provides for some rates, or credits, to “phase out”, rather than being terminated immediately. The Company also proposes to eliminate the controlled water heater rate. This rate has been closed to new customers for several years, and was introduced at a time when the Company was still operating as part of a vertically integrated entity, when the value of such a program to the Company would have been much different. The Company no longer actively controls most of the water heaters, and is planning to cease control of all water heaters in the near future. Likewise, the Company proposes to eliminate its Auxiliary Service provision, and move the customers currently covered by that provision to the appropriate backup service rate.

A complete list of the current rates and the proposed mapping of current rates onto the proposed rates is set forth in Exhibit 2 of the Settlement (p. 41), and the design and structure of the distribution rates proposed in the Settlement are found in Exhibit 5, all of which are described in detail in Ms. Lloyd's testimony.

Backup Service Rates

Q. Please describe the redesign of the backup rates.

A. With regard to the backup rate design, the Settlement proposes rate designs that provide for a greater portion of revenue recovery from backup service customers on the basis of their "backup demand," rather than on the amount of kWh their on-site generating unit produced. The redesign of the rate in this manner was in part a response to criticisms of the Company's current backup rate design that it charged customers too much on the basis of what their generators produced, and thus created a disincentive to their operation.

The proposed backup rate design (Rates B-32 and B-62), however, rather than being based on usage, is based on the metered maximum output of the on-site generating unit at the time of the customer's monthly facility peak. This rate design is based on assessing customers on the basis of their maximum facility peak, which in essence is the amount of load that the Company must be prepared to instantaneously serve, or backup, in the event that the customer's generator goes out of service. Under the new rate design, backup service customers would also avoid transmission charges for the load they serve on site. Such treatment is consistent with the theory of electric system diversity, and reflects the fact that the distribution system is comprised of a greater proportion of dedicated facilities sized to serve fewer customers, while the transmission network is more of a "shared" system. To mitigate the effect on customers of the termination of the "grandfathering" under the Auxiliary Service provision, the proposed backup service rates provide for a five-year phase-in for former Auxiliary Service customers commencing January 1, 2005. Ms. Lloyd's testimony includes greater detail regarding the proposed backup service rate designs.

Q. Could you explain how the provisions of G.L. 39-2-1.4 apply to the backup service rates included in the Settlement?

A. Under the Settlement, the parties agreed that the proposed backup service rates fully complied with the provisions of G.L. 39-2-1.4(a) and (b), as applied to current circumstances, loads and generation of backup service and Auxiliary Service customers. However, all of the parties reserved their rights to petition the Commission under G.L. 39-2-1.4(b) to amend Rate B-32 or Rate B-62 on the basis of changes in such circumstances, load and generation, and all parties reserved their rights to challenge any such petition. In addition, in the Settlement, the parties agreed that because the proposed Rate B-32 and Rate B-62 rates are cost-based, they are not discounted based on any of the factors the Commission may consider in a petition under G.L. 39-1-1.4(c). Accordingly, the Settlement provides that any party is free to file a claim for a discount from the backup service rates under the provisions of G.L. 39-1-1.4(c), subject to any party's right to challenge such a petition, and Narragansett's right to recover any discounts or credits from other customers pursuant to that section.

<u>Low Income Rate</u>

Q. Could you please explain the proposed redesign of the low income rate?

A. Under the Settlement, the zonal distinctions which differentiate among low income (Rate A-60) customers of the former BVE, Newport and Narragansett would be eliminated. Given the implementation of the merger over four years ago, continued differential treatment of similarly situated customers did not appear justified. Next, the rate was redesigned to apply usage discount to the first 500 kWh per month of customer usage (the exemption from the customer charge continues). Targeting the usage discount to the first 500 kWh per month of usage, rather than applying the discount to all usage amounts, was intended to create a greater conservation incentive under Rate A-60 (the average monthly usage for Rate A-60 customers is just below 500 kWh). Ms. Lloyd's testimony provides more detail about the Rate A-60 rate design, as well as about the other rate design changes proposed in the Settlement.

<u>Shared Savings Amount</u>

Q. Please describe the resolution in the Settlement of the Company's shared savings allowance.

A. Pursuant to the Settlement, the Company's shared savings allowance would be set at $4.645 million and would be capped at that level through 2019, subject to downward adjustment or elimination pursuant to the reopener protections. The calculation of the shared savings amount is set forth in Exhibit 1, page 3 of 3 (p. 38). The settled amount is substantially less than the shared savings amount the Company filed for in its first Savings Proof in Docket No. 2930 (i.e., $7.88 million, based on total proposed savings of $15.77 million using the methodology included in the 2930 Settlement).

The Company's shared savings allowance is to be included in future earnings reports and costs of service filings (subject to the reopener protections) as a cost of service item. To the extent that the Company is able to operate its business at an earnings level at or above the allowed rate of 10.5 percent ROE, the Company will enjoy the full extent of its shared savings allowance. However, to the extent the Company's earnings are less than 10.5 percent, the Company will not have earned its shared savings allowance.

Q. Do customers see any portion of shared savings?

A. Yes, customers see their portion of shared savings immediately as part of the $10.243 million distribution rate reduction. As indicated in Exhibit 1 to the Settlement, the proposed $10.243 million rate reduction in the Settlement is composed in part of customers' share of shared savings of $5.0 million. Customers receive their share of shared savings up front and without risk in the form of lower rates immediately. By contrast, for Narragansett to realize its $4.645 million portion of shared savings, it must continue to implement and maintain cost reduction and control measures. Thus, customers receive their share of the savings whether or not Narragansett actually realizes its own share of those savings.

Q. How does the shared savings amount established in the Settlement relate to the second savings verification provided for under the 2930 Settlement?

A. The Settlement provides that the determination of the shared savings amount, and the use of the 2005 rate year to establish new rates effective October 2004, serve as the "Second Savings Verification" provided for in the 2930 Settlement, and that no further savings verification would be required. The 2930 Settlement provides in part 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. (2930 Settlement, Section 8(B)).

As shown in Exhibit 1, customers have been fully credited with their $5.0 million share of the savings through reduced distribution rates that will be implemented under the Settlement filed in this proceeding. The Parties have agreed that this filing 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 savings proof, which is now pending before the Commission, and will eliminate the need for a second proceeding altogether.

<u>Earnings Sharing Mechanism</u>

Q. Does the Settlement include an earnings sharing provision?

A. Yes. As I mentioned above, the earning sharing mechanism established in the 2930 Settlement also would continue under this Settlement, however, the threshold at which earnings sharing would begin would be recalibrated from 12.0

percent to 10.5 percent. Under the Settlement, accumulated earnings up to and including 100 basis points above Narragansett's authorized ROE of 10.5 percent (i.e., earnings between 10.5 percent up to and including 11.5 percent), would be shared 50/50 between customers and the Company. Earnings over 11.5 percent would be allocated 75 percent to customers and 25 percent to the Company.

In calculating its earnings, the Company will continue to use an imputed capital structure. Because Narragansett's actual equity on its books is quite high due, in part, to the recording of acquisition premiums and transaction costs as a result of the NEES/EUA and NEES/National Grid mergers, the Settlement provides for the use of an imputed capital structure for purposes of calculating the Company's earnings through the rate freeze period and until the Company's first cost of service case after the rate freeze. The capital structure is based on 45 percent debt, 5 percent preferred equity, and 50 percent common equity. The return on common equity is set at 10.5 percent, while the preferred equity and debt rates are 4.58 percent and 7.57 percent, respectively. These preferred equity and debt rates represent the Company's actual cost rates for calendar year 2003, and are each slightly lower than the rates used in the 2930 Settlement (5.20 percent and 7.81 percent, respectively). The 10.5 percent common equity rate is the same as that established in the 2930 Settlement, and is well within the range of reasonableness as compared to the rates of returns established for other utilities within the region and nationally. The effect of these adjustments will be that earnings sharing would be triggered at a lower level than under the 2930 Settlement.

Q. Does the Settlement provide for any adjustments in the calculation of the Company's earnings reports?

A. In preparing its earnings reports, the Company may not make adjustments to actual results for known and measurable changes, but shall make normalizing adjustments or other adjustments consistent with established Commission ratemaking principles. This was also the case under the 2930 Settlement. The Settlement also explicitly provides, however, the manner in which pension expense is to be treated for earnings report purposes. Specifically, the Settlement provides that pension expense should be reflected in earnings reports in the same manner in which it is reflected in the Company's financial books, which is pursuant to the provisions of Financial Accounting Standard ("FAS") No. 87 and FAS No. 88. In addition, the Settlement explicitly provides that post-retirement benefits other than pensions are to be reflected for earnings report purposes in the same manner as recorded on the Company's books, i.e., under FAS No. 106. Notwithstanding the earnings report treatment applicable for pension expense experienced during the rate freeze, the Settlement provides that the costs of the 2003 VERO program are to be deferred and amortized over 10 years beginning January 1, 2004. Thus, an annual amortization amount associated with the 2003

VERO will be reflected in earnings reports going forward throughout the proposed rate freeze period.

Q. When will the Company file its annual earnings reports with the Commission?

A. The Settlement provides that the Company is to file the annual earnings report for a year during the rate freeze period no later than May 1 of the subsequent year. The final earnings report that is to reflect the average return during the rate freeze period is to be filed no later than May 1, 2010.

<u>Accumulated Shared Earnings and Customer Credit</u>

Q. How does the Settlement address the issue of the customers' portion of shared earnings accumulated during the 2930 Settlement rate freeze?

A. The Settlement estimates the amount of customers' share of excess earnings through December 31, 2004 (which will be reconciled to actual once earnings subject to sharing are final) and provides for a Customer Credit per kilowatt-hour that Narragansett would credit customers over the twelve months following the effective date of the proposed distribution rates. The Customer Credit is estimated to be $22.8 million as shown in Exhibit 8. The principal components of the Customer Credit would be: customers' share of Narragansett's estimated shared 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 lost revenue associated with the low income expansion that are recoverable under the 2930 Settlement. The 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 as provided in Section 7(A) of the Settlement.

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 costs through December 31, 2004. As indicated in the Settlement, the Service Quality Penalties included in the $22.7 million do not include any penalties that may accrue in 2004, and the amounts for Bonus Tax Depreciation, Low Income Expansion Costs, and the earnings themselves are estimates. All 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 Narragansett due to customers in Narragansett's first annual reconciliation filing occurring after the expiration of the Customer Credit.

Q. How does the Settlement propose to allocate the Customer Credit?

A. The parties to the Settlement agreed that the Customer Credit should be allocated in essentially the same manner as the proposed distribution rate reduction is to be allocated; that is, the credit is to be allocated among rate classes based 50 percent on each rate class's respective share of kWh deliveries, and 50 percent on the rate class's respective contribution to distribution revenue. The proposed allocation is set forth in Exhibit 4 of the Settlement.

Q. Please describe how the Settlement comports with the provisions of G.L. 42-98-1.1, which was recently enacted.

A. Under G.L. 42-98-1.1, the cities of Providence and East Providence have the option, through action of their respective City Councils, to direct some or all of the respective Customer Credit that would otherwise go to the Company's customers in those cities towards the costs of placing the E-183 transmission line in those cities underground. The Settlement is structured so that when the cities exercise the option, Narragansett can direct the Customer Credit of the customers in these cities towards the cost of burial of the E-183 transmission line in accordance with the settlement approved by the Energy Facilities Siting Board in Docket SB-2003-1.

<u>Deferred Uplift Costs</u>

Q. The Settlement includes a resolution of the dispute presented in Docket No. 3616 regarding deferred uplift costs. Please describe the proposed resolution of this issue.

A. Narragansett has deferred recovery of approximately $7.45 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, which has been designated Docket No. 3616, and the facts will not be repeated here. The Settlement resolves all issues associated with the recovery of these costs by disallowing recovery of 25 percent of what has been deferred and allowing recovery of the remaining $5.6 million over the next three years in Narragansett's Transmission Service Cost Reconciliation. So as not to affect the accumulated shared earnings amount, the Settlement also provides that the 25 percent amount disallowed for recovery would also be disallowed for earnings report purposes. In addition, the Parties agree that Narragansett shall be allowed to recover all ongoing uplift costs through their inclusion in Narragansett's Transmission Service Cost Reconciliation.

<u>Environmental Response Fund</u>

Q. Please describe the proposed changes to the Company's Environmental Response Fund in the Settlement.

A. Under Section 8 of the Settlement, 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 2930 Settlement, and Narragansett has agreed to expand the resources available to the Fund by eliminating the potential to reduce funding under the contingency reserved in Docket 2930 (Order No. 17,354, Jan. 29, 2003), and by including net gains on the sales of property that may be cleaned up using resources from the 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.

Service Quality Performance Standards

Q. What is included in the Settlement regarding the Company's Service Quality Performance Standards?

A. As the result of time limitations, the Parties were unable to agree to any specific changes to the Company's Service Quality Performance Standards from the standards in place under the 2930 Settlement. As a result, the Parties have not proposed any substantive changes to the Service Quality Performance Standards in this Settlement, and have agreed that the substantive review of the standards planned for Docket No. 3628 should continue. However, to assure the economic balance in the Settlement is maintained, the Parties agreed that the review in Docket No. 3628 should not change the maximum penalty that can be assessed under the currently effective plan, the offsetting of penalties (including the carry forward of offsets) should continue, and the standards should continue to be calibrated based on historical performance.

Other Settlement Provisions

Q. Are there any other major items covered by the Settlement that you would like to mention?

A. Yes, however, for the most part, they are just a continuation of elements that were adopted as part of the 2930 Settlement approved in 2000. These include:

- Storm Fund funding at previously approved levels;
- Annual reporting on property sales;
- Use of depreciation rates and tax normalization practices adopted in the 2930 Settlement;
- Continued deferral of Narragansett's deferred tax deficiency until the Company's first cost of service case to establish rates after the rate freeze; and
- Application of attachment fees and other similar fees as directed in the 2930 Settlement.

IV. Proposed Modifications to the Settlement

Q. Does the Company propose any changes to the Settlement as filed on June 29, 2004?

A. Yes. Subsequent to the filing of the Settlement, the Commission conducted extensive written discovery on the Settlement. The Commission also conducted open meetings on August 19 and September 10, and a technical session on September 1, at which it provided direction to the Company and the other settling parties regarding the Settlement. In addition, through a series of Commission-sponsored public hearings in Pawtucket, Warwick, and East Providence, as well as through discussions with intervenors in this docket and other interested parties, the Company has received valuable feedback on the Settlement. As a result, the Settling parties have reached agreement on a number of proposed modifications to the Settlement. Specifically, the Parties have agreed to amendments in the following areas:

- **Residential Rates**
  >> Elimination of the Home Energy Management program and related credits;

- **General Service Rates**
  >> Amendment to phase out the E-40 Storage Cooling rate;

- **Exogenous Events**
  >> Symmetrical interest provision on the accumulation of exogenous event costs/credits;

- **Shared Earnings**
  >> Provisions governing the interim refunding to customers of accumulated shared earnings during the rate freeze along with interest on unreturned balances;
  >> Clarification on post-rate freeze earnings sharing reports and refund of customer shared earnings;

- **Service Quality Program**
  >> Amendment to the Service Quality Performance Standards provisions regarding penalties, offsets and the timing of credits to customers;

- **Miscellaneous**
  >> Miscellaneous changes to address non-substantial corrections to the June 29 filing.

1. Residential Rates

Home Energy Management Program

Q. Please describe the proposal to eliminate the Home Energy Management Program.

A. The Home Energy Management (“HEM”) Program provides direct control of residential water heaters for load management purposes. The program has been closed to new customers since 1998, and there are currently only about 4000

HEM customers. Customers on the HEM Program receive service under Narragansett's water heater control rate. As mentioned in Ms. Lloyd's testimony, the Settlement as filed June 29 also provides for the termination of all of the other (i.e., non-HEM) water heater control credits.

The program costs (exclusive of the customer credits) of the HEM Program have traditionally been paid under Narragansett's demand-side management ("DSM") program. Customer credits for HEM customers, on the other hand, have been reflected in and recovered from base distribution rates. HEM Program costs include the cost of any needed repairs to the existing system and the costs of broadcasting the control signal via radio. The typical program budget has been approximately $150,000 per year. The program is currently offered by three National Grid companies: Narragansett, Massachusetts Electric Company, and Granite State Electric Company. Many of the program costs currently are shared between the three companies, with Narragansett incurring about 22 percent of shared expenses.

The program was developed during the late 1980s when Narragansett still operated as part of a vertically-integrated utility system that owned generating facilities. Since that time, the Company has sold its generation, and the dispersed control provided by the HEM Program provides considerably lower value than it had previously.

The computer used by the Company to send the HEM signals to the radio station and the program database are of 1980s vintage and currently not supported by their manufacturers. The Company has determined that a $300,000 investment would be necessary to invest in new equipment and software to continue the program. Given the relatively small (and shrinking) number of customers on the HEM Program, the availability of other broad load response programs (such as programs sponsored by ISO New England), Narragansett, in agreement with the Rhode Island DSM Collaborative, will be proposing to end the HEM Program. Thus, the Parties to the Settlement in this case have agreed that the Company should terminate the controlled water heater credits at the same time the HEM Program is terminated. This would coincide with the termination of all of the other water heater control credit provisions. Accordingly, the Company has amended its proposed tariff to reflect the termination of the controlled water heater credits, and remove the credit from the design of Rate A-16's distribution rates. Hence, the Company has revised its proposed Rate A-16 distribution rate design as a result of the elimination of the HEM Program and termination of the associated controlled water heater credit. This is described in Ms. Lloyd's testimony.

2. <u>General Service Rates</u>

<u>E-40 Storage Cooling Rate Amendment</u>

Q. Please describe the Company's proposal regarding the E-40 Storage Cooling Rate.

A. Subsequent to the June 29 Settlement filing, the Company had several discussions with a customer currently served on Rate E-40. As a result of concerns raised by that customer, the Company is proposing to amend the Settlement so as rather than terminate the Rate E-40 immediately, the Company will close the rate to new customers on the effective date, and will terminate the rate effective December 31, 2006. This extension of time provides additional notice to current Rate E-40 customers that the rate will eventually be eliminated, and provides them additional time to evaluate actions they may wish to take. Any Rate E-40 customer that wishes to terminate service under the rate prior to the scheduled termination date also can do so, as Ms. Lloyd describes.

3. <u>Exogenous Events</u>

<u>Symmetrical Interest Provision on Exogenous Event Costs/Credits</u>

Q. Please describe the proposed amendment regarding exogenous event interest.

A. At the technical session on September 1, the Commission raised a concern about the non-symmetrical applicability of potential interest on exogenous events (Settlement Section 2(C)(1), p. 6). The Company and Division also responded to previous data requests from Commission Staff on this aspect of the Settlement (Company's Response to Data Request 1-54; Division's Response to Data Request 1-34). In order to address the concern raised by the Commission, the

Parties have agreed to amend the Settlement to provide comparable interest provisions for deferred exogenous event costs as well as for deferred exogenous event credits, and will be submitting revised Settlement language as part of the amended Settlement filing due September 17.

4. Shared Earnings

Provisions for the Interim Refunding of Accumulated Shared Earnings During the Rate Freeze

Q. What does the Company propose with respect to any possible refunding of accumulated shared earnings to customers during the rate freeze period in the Settlement?

A. Under the Settlement, the amount of earnings available to be shared with customers is to be determined on the basis of the Company's average ROE during the rate freeze, and are to be credited to customers in a manner approved by the Commission following the rate freeze. However, the Settlement also provides that Narragansett has the option to propose to return to customers some portion of accumulated shared earnings before the end of the rate freeze period. At the technical session on September 1, the Commission asked the Company to propose criteria that it would apply to determine the circumstances under which the Company would exercise its option to return some portion of accumulated shared earnings to customers before the expiration of the rate freeze.

As part of the amended Settlement to be filed September 17, the Parties have agreed on a mechanism whereby Narragansett could return to customers a portion of the shared earnings accumulated during the rate freeze period. The mechanism would be based on a "deductible" approach, where accumulated earnings over $8 million during the rate freeze would be returned to customers in the following year. Accumulated shared earnings below the deductible amount would accrue interest at the customer deposit rate. Any remaining amount of accumulated shared earnings at the end of the rate freeze (i.e., including amounts below the deductible and interest) would be returned at the end of the rate freeze. To the extent that the Company "over refunded" shared earnings during the rate freeze period, it would accrue interest (also at the customer deposit rate) on the over-refunded amounts, and would reconcile and recover any such "over refund" amount through a surcharge. Any shared earnings returned would be based on the allocation methodology in Exhibit 3 of the Settlement (50 percent kWh deliveries, 50 percent rate class revenue) unless the Commission approves a different methodology at the time.

<u>Post-Rate Freeze Earnings Sharing Reports</u>

Q. What is proposed with respect to the Settlement provisions on the return of shared earnings after the rate freeze period?

A. Although the Settlement provides that after the rate freeze period the Company shall file annual earnings reports with the Commission each year, there is no explicit provision regarding the return to customers of their share of any shared earnings that may accrue under the earnings sharing mechanism during the years following the rate freeze. At the technical session, the Division stated its position that the return of any shared earnings accrued following the rate freeze should be addressed annually. The Company concurs. Accordingly, as part of the changes to be reflected in the amended Settlement to be filed September 17, the language will make clear that any accrued shared earnings reflected in annual earning reports for the period following the rate freeze shall be subject to disposition by the Commission, and shall be credited for the benefit of customers each year in a manner determined by the Commission.

5. Service Quality Program

Amendment to the Service Quality Performance Standards

Q. Is the Company proposing any amendments to the Service Quality ("SQ") Performance Standards contained in the Settlement?

A. The Company is not proposing any changes to the standards included in its SQ plan. As indicated in the Settlement, the parties agreed that the review and modification of the underlying SQ standards should be conducted in the context of Docket No. 3628. However, the parties did agree that existing provisions relating to penalty amounts, offsets, and the use of historical performance data should continue.

At the open meeting on August 19, the Commission expressed an interest in potentially revising the SQ plan. Specifically, the Commission indicated it might favorably consider changes that provide for annual SQ performance measurements, no offset carry forward from prior years, and an annual crediting to customers of any accrued penalties rather than waiting until the end of the rate freeze. In exchange for such changes, the Commission indicated that it might be appropriate to reset the maximum penalty level to approximately one-percent of distribution revenues, and to eliminate the provision in the current SQ plan that provides for the potential doubling of penalties if the Commission finds that there has been a significant and persistent deterioration in the Company's quality of service.

The Company and other Parties have discussed the changes proposed at the open meeting August 19 and agree that they are reasonable. Accordingly, the Parties will be submitting an amended Settlement document on September 17 that incorporates the changes to the SQ plan described above.

6. Miscellaneous

Q. Are there any other changes the Company is proposing to the Settlement at this time?

A. Yes. Since the filing on June 29, the Company has identified several non-substantive changes and corrections that are required to the exhibits, primarily to the proposed tariff provisions. These changes will be reflected in marked-to-show-changes text included in the September 17 filing of an amended Settlement.

V. Status of Discussions with Other Parties

Q. Has the Company been in contact with intervenors or other parties or groups regarding the Settlement?

A. Yes. The Company and the other Parties have been involved in discussions with representatives of People's Power and Light, which is an intervenor in this case, representatives of the George Wiley Center, as well as other individuals that submitted comments in this proceeding.

Q. What purpose and status of those discussions?

A. These parties have proposed a number of changes to the Settlement from what was initially filed with the Commission on June 29. The Parties are continuing to discuss and evaluate some of the proposed changes offered by these groups. To the extent the Parties agree to any further proposed Settlement amendments as a result of these discussions and evaluations, they will be reflected in and explained as part of the amended Settlement filing that will be made on September 17.

VI. Conclusion

Q. Does this conclude your testimony?

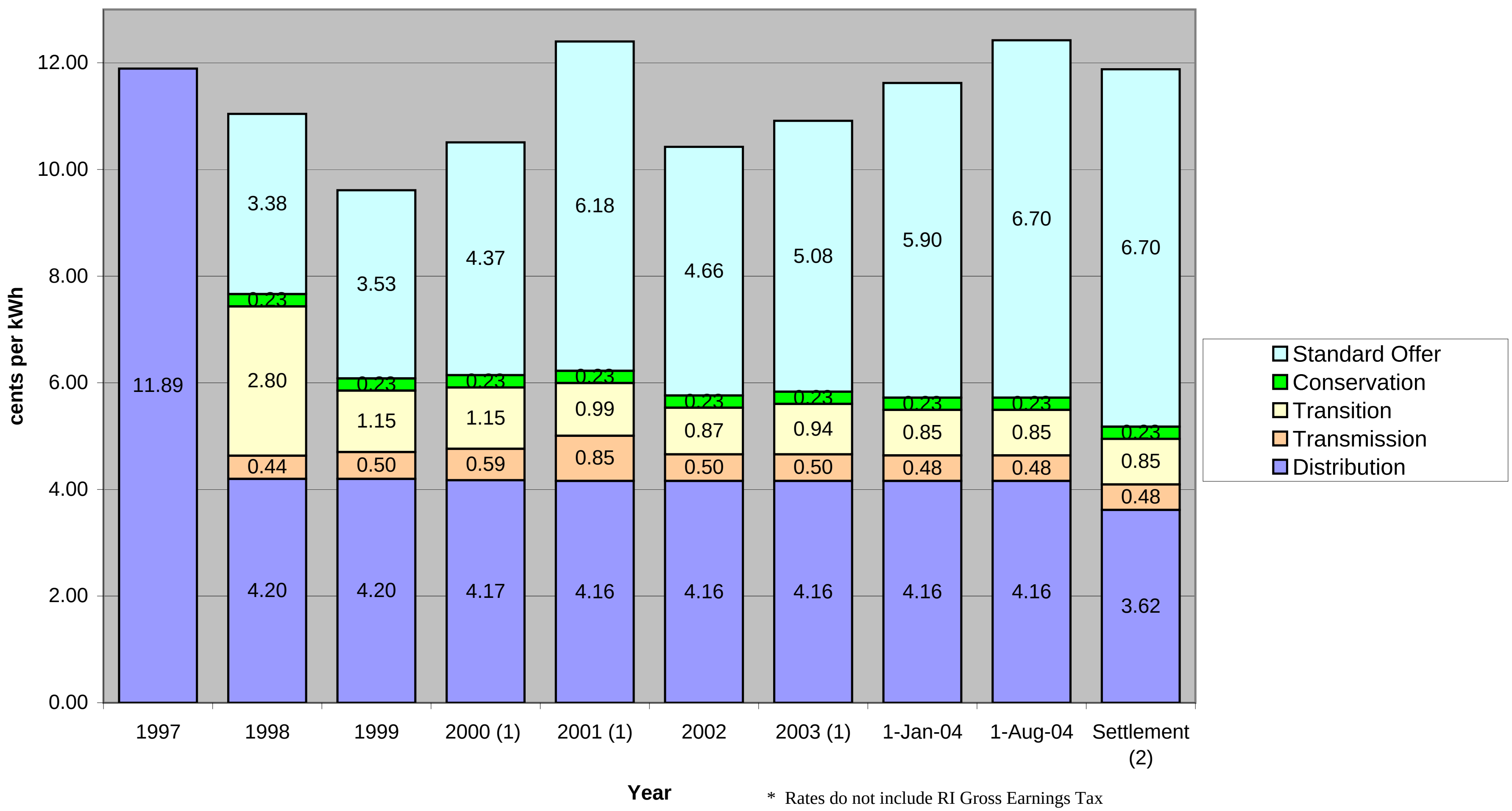
A. Yes.

Exhibit CAG-1

Exhibit CAG-1

Average Residential Rates from 1997 to Present

Narragansett Electric Company
Average Residential Rates from 1997 to Present

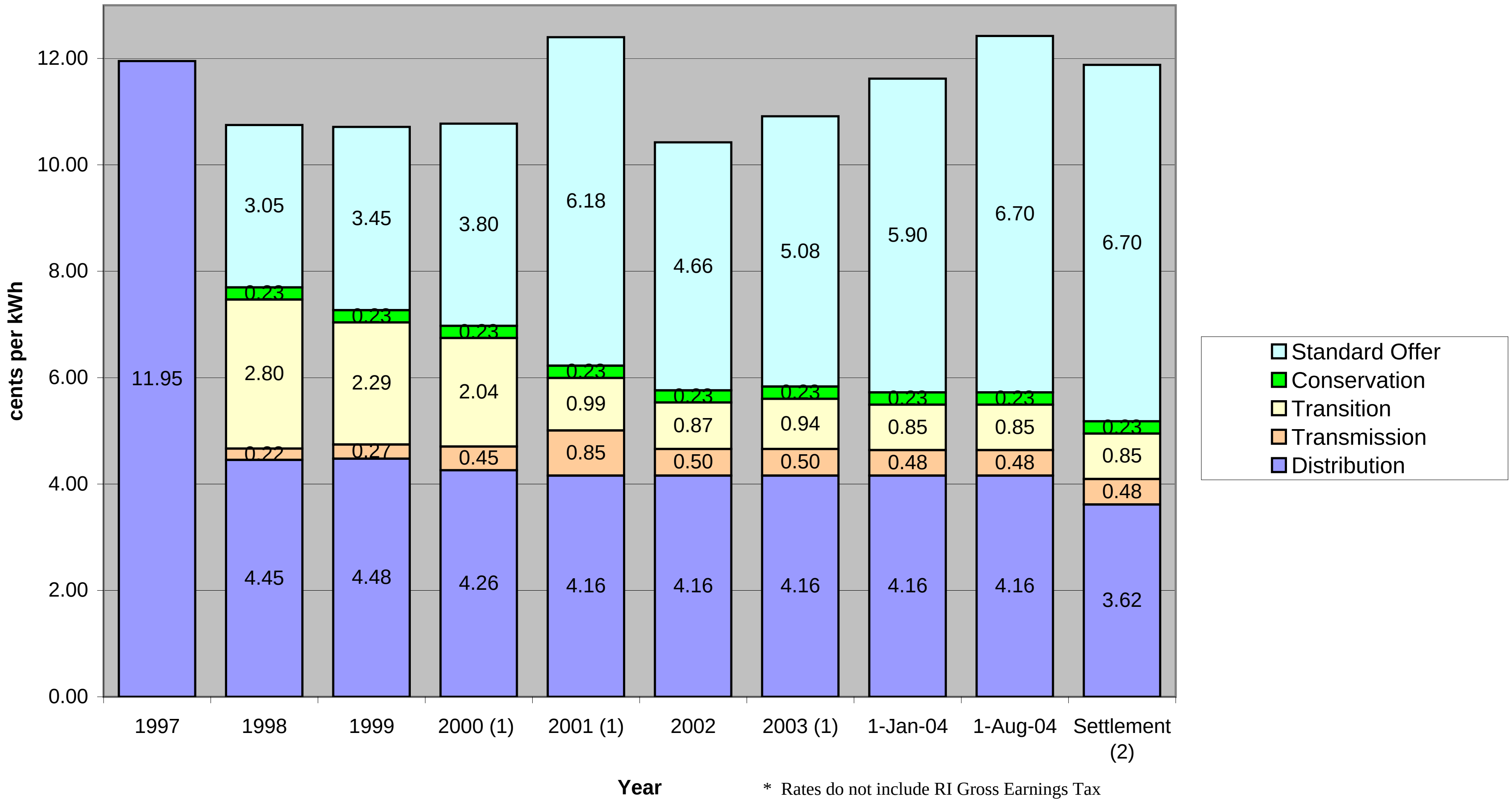


* Rates do not include RI Gross Earnings Tax

(1) Multiple rate changes occurred in this year. Rates are based on weighted average of all rates billed during the year.

(2) Includes Customer Credit of 0.329¢ per kWh

Former Blackstone Valley Electric Company
Average Residential Rates from 1997 to Present

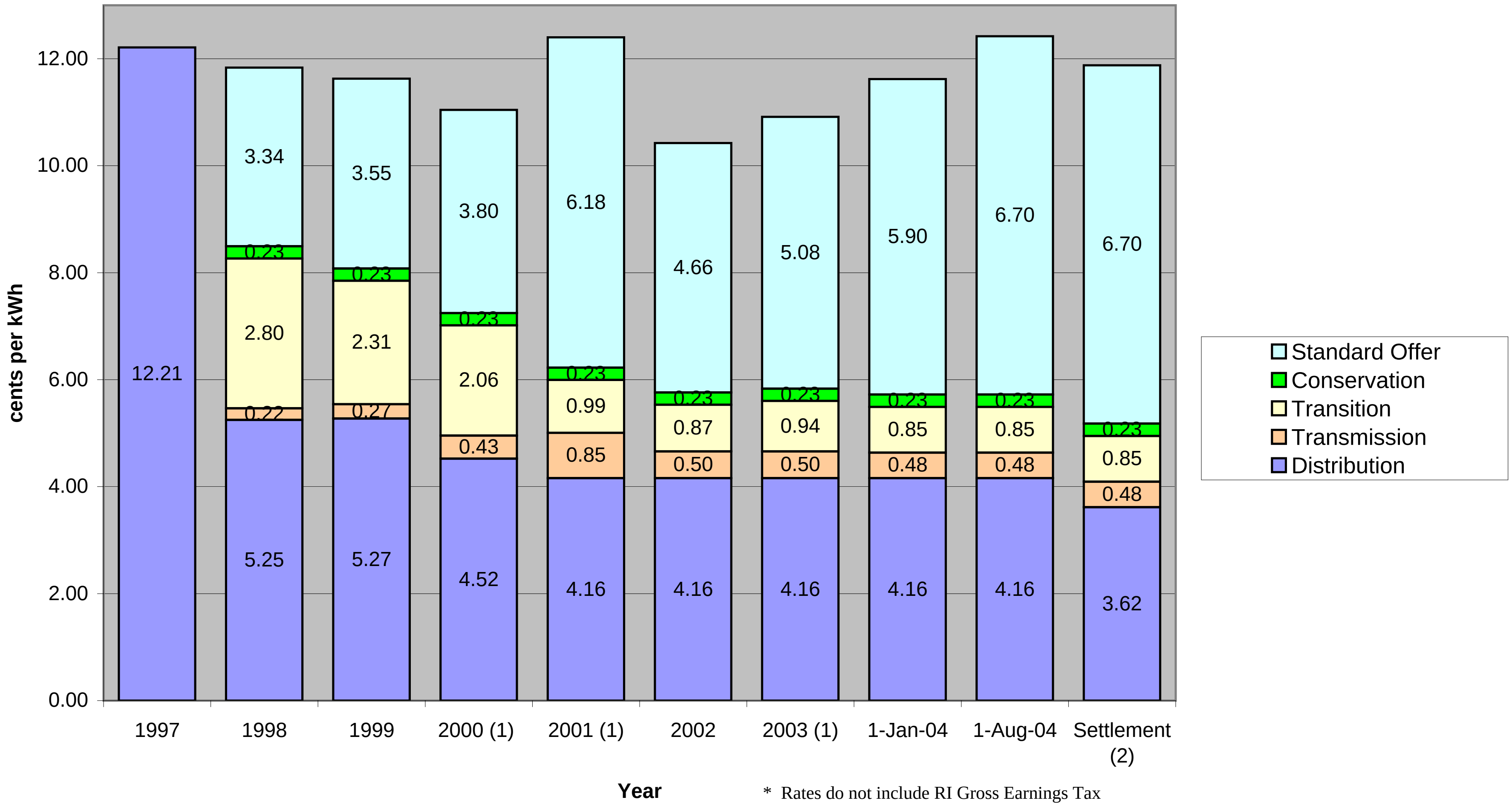


* Rates do not include RI Gross Earnings Tax

(1) Multiple rate changes occurred in this year. Rates are based on weighted average of all rates billed during the year.

(2) Includes Customer Credit of 0.329¢ per kWh

Former Newport Electric Corporation
Average Residential Rates from 1997 to Present



* Rates do not include RI Gross Earnings Tax

(1) Multiple rate changes occurred in this year. Rates are based on weighted average of all rates billed during the year.

(2) Includes Customer Credit of 0.329¢ per kWh

DIRECT TESTIMONY

OF

MICHAEL D. LAFLAMME

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I. INTRODUCTION AND QUALIFICATIONS

Q. Please state your full name and business address.

A. My name is Michael D. Laflamme. My business address is 55 Bearfoot Road, Northboro, Massachusetts 01532.

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

A. I am Manager of Regulatory Support for National Grid USA Service Company Inc. National Grid USA Service Company provides engineering, financial, administrative and other technical support to subsidiary companies of National Grid USA, including Narragansett Electric Company ("Narragansett" or "Company")

Q. Please provide a brief summary of your educational background and training.

A. In 1981 I earned a Bachelor of Science degree in Business Administration, emphasis in Accounting, from Bryant College in Smithfield, Rhode Island.

Q. What is your professional background?

A. From 1981 through April 2000 I was employed by various subsidiary companies of Eastern Utilities Associates ("EUA"), including Blackstone Valley Electric Company ("Blackstone") and EUA Service Corporation ("EUASC") which provided various accounting, financial, engineering, planning, data processing and other services to all EUA System companies.

I joined Blackstone in 1981 as a junior accountant and attained a staff accountant position prior to transferring to the revenue requirements section of EUASC's Rate Department in 1985. I held progressively more responsible positions in revenue requirements prior to transferring to the Treasury Services department of EUASC in 1988. I was promoted to the position of Manager of Treasury Services in 1991. The EUA System was acquired by National Grid USA in early 2000, at which time I joined the National Grid USA Distribution Financial Analysis Group.

Q. What is your relationship to Narragansett?

A. My current duties include supporting cost of service and revenue requirements analyses for the National Grid USA Distribution companies in New England, including Narragansett.

Q. Have you previously testified before a regulatory commission?

A. Yes, I have testified in proceedings before the Rhode Island Public Utilities Commission ("Commission"), the Massachusetts Department of Telecommunications and Energy and the New Hampshire Public Utilities Commission. I have also provided primary support for revenue requirements witnesses in proceedings before the Federal Energy Regulatory Commission.

II. <u>PURPOSE OF TESTIMONY</u>

Q. What is the purpose of your testimony?

A. My testimony is intended to supplement the direct testimony of Mr. Gavilondo in the instant docket and to provide additional explanation and support for the Distribution Rate Plan Stipulation and Settlement filed with the Commission on June 29, 2004 ("New Settlement"). Specifically, at an open meeting of the Commission held on August 19 several areas of concern were raised by the Commission, which I will address individually in this pre-filed testimony. Many of these issues were also discussed at a technical session held on September 1, 2004 and at another Commission open meeting held on September 10, 2004.

Q. Would you summarize the areas of concern that were raised at the August 19th open meeting and subsequent sessions?

A. At the August 19th open meeting, the Commission identified six areas of concern for which it was seeking additional information and/or explanation, and these areas were further addressed at the subsequent sessions. The six issues are as follows:

1. Cost of Service - The Company provided several different Cost of Service amounts in both the June 29th filing and in response to subsequent Commission data requests, generating some confusion.

2. Second Savings Proof - Concern over the perception that the Second Proof of Savings was eliminated in the New Settlement as well as the operation of the Re-opener provisions as illustrated in Exhibit 7 of the New Settlement.

3. Shared Earnings - Concern over the Shared Earnings provisions in that the customers' share of earnings will be calculated with reference to a five year average

return and not credited to customers until the end of the rate freeze period provided for in the New Settlement, and the absence of interest on outstanding balances of customers' earnings share.

4. Five Year Service Quality Plan - Concern over the five year accumulation and penalty offset carry forward provisions of the service quality plan economics included in the New Settlement. The Commission expressed some interest in annual service quality reviews and refunds with only intra-year penalty offsets in exchange for capping the penalties at 1% of distribution revenue and the elimination of the doubling of penalty provisions for significant and persistent poor performance.

5. Storm Fund - Concern over the storm fund balance and whether the fund balance should be capped at a stipulated level.

6. Concern over the Company's bill format with regard to the Company's customers in the cities of Providence and East Providence in the event that their share of the estimated $22.8 million Customer Credit arising out of shared earnings for the period 2000 through 2004 is applied to underground the E-183 line.

III. <u>COMMISSION ISSUES</u>

<u>1. Cost of Service</u>

Q. Would you please explain the relevance of the different Cost of Service amounts that were provided by the Company?

A. Certainly. Several cost of service amounts were provided by the Company, as summarized in the Company's response to Commission Data Request 1-92, but each serves a different purpose or was provided in order to best respond to a particular Commission data request. However, the most important cost of service amount, indeed the cost of service level which forms the foundation for the New Settlement proposal, is contained in Exhibit 1 of the New Settlement. As shown on Page 1 of Exhibit 1 at Line 7, the parties settled on a 2005 cost of service (including the Company's share of savings) of $220,604,000. By agreeing to the $220,604,000 cost of service (including shared savings), the Company has assumed the risk that it can indeed operate its distribution business at that level of revenue in order to earn its agreed-upon share of savings of $4,645,000.

In arriving at the settled 2005 cost of service of $220,604,000, the parties also reviewed a draft cost of service for a 2005 rate year, very similar to the cost of service provided with the response to Commission Data Request 1-91. The cost of service included with the response to Commission Data Request 1-91 of $220,403,000 excluded any of the $4.645 million of shared savings allowance for the Company that is reflected in the settled cost of service of $220,604,000. The cost of service included in the response to Commission Data Request 1-91 is for rate year 2005 and was developed using a 2003 test year plus adjustments typically made in a Company-filed rate change request. Thus, the settled 2005 Cost of Service included in the New Settlement, upon which the proposed distribution rates were designed, $220,604,000, is nearly equal to the draft 2005 rate year cost of service calculated incorporating established ratemaking principles and typical test year adjustments, which excluded any allowance for the Company's share of savings.

Consequently, as noted earlier and in the response to Commission Data Request 1-92, the Company must operate its distribution business at a level below its projected 2005 cost of service to earn its agreed upon share of total savings. However, the customers' share of total savings has been fixed and provided to customers via the immediate rate reduction.

This may be best illustrated by an example. If the Company operates its distribution business at a cost of $220,403,000, then the Company will have earned only $201,000 of shared savings, since it would be incurring costs that are slightly below the 2005 rate year revenue requirement of $220,604,000. However, customers will continue to enjoy their full $5,000,000 share as a component of the proposed $10.2 million rate decrease regardless of the Company's actual cost to serve.

Q. The reopener provisions of the New Settlement, as illustrated in Exhibit 7, appear to include a cost of service for 2005 of $233,047,000 (Exhibit 7, Page 2, Line 23). What does this amount represent?

A. The reopener provisions from the Original Settlement approved by the Commission in Docket No. 2930 were intended to measure, on an average kilowatt-hour basis, Company-proposed distribution rate changes occurring after the initial rate freeze period against the average distribution revenue per kilowatt-hour that customers could have reasonably expected under two separate escalation scenarios. As such, these reopener revenue scenarios from the Original Settlement were maintained in the New Settlement. As described in the response to Commission Data Request 2-1 and Commission Data

Request 3-11 and as illustrated on Exhibit 7, Page 1, Line B of the graph is intended to represent distribution rates established at the outset of the Original Settlement escalated at the rate of inflation through 2014, or a rate path customers could have reasonably expected absent the merger. It is important to note that the distribution rates established at the outset of the Original Settlement were based on the Benchmark Cost of Service of $210,000,000 less annual amounts for the following: a settlement credit of $2,700,000, hold harmless credits valued at $425,000, and an estimated $575,000 benefits resulting from the expansion of the low income eligibility requirements.

Line A of the graph contained in Exhibit 7 represents the settled rate path under which the Company must maintain its rates in order to continue to prove the existence of merger savings. The Line A rate path provides no allowances for inflation during the initial rate freeze period of 2000-2004, a reopener index allowance of 1.9% annually from 2005 through 2009 and annual allowances equal to 80% of inflation for the remainder of the settlement period.

These adjustments in Exhibit 7 are different from the Benchmark cost of service that was calculated under Exhibit 4 of the Original Settlement, which was used to calculate proved savings in Exhibit 1 of the New Settlement. For example, the 2005 Adjusted Benchmark Cost of Service used to calculate shared savings is only $225,604,000 as shown on page 1, line 3, of Exhibit 1 to the New Settlement. The differences stem from the fact that the Benchmark cost of service used to calculate shared savings as set forth on page 2 of

Exhibit 1 to the New Settlement and Exhibit 4 in the Original Settlement is only escalated by 50 percent of inflation and 30 percent of sales growth. In addition, the Benchmark cost of service used to calculate shared savings begins with a base of $210 million, rather than the settled rate levels used for the re-opener analysis.

Thus, page 2 of Exhibit 7 at Line 17, indicates a re-opener Cost of Service amount for 2005 of $230,847,000. This amount represents proforma 2005 distribution revenue under the Company's current distribution rates, or the rates established at the outset of the Original Settlement. To that amount is added the lost revenue embedded in current rates resulting from the expansion of the low income discount, which the Company was to surcharge beginning 2005 pursuant to the terms of the Original Settlement. As shown on Line 21 of Exhibit 7, those lost revenues were incorrectly valued at $2,200,000 with the correct value being $2,576,802 as estimated for 2004 on Exhibit 8, Page 2, Line 1. As shown on Line 31, of Page 2 of Exhibit 7, the average distribution revenue per kilowatt-hour for 2005 should be 2.977¢. This corrected average per kilowatt-hour rate, therefore, represents the Original Settlement per kilowatt-hour rate adjusted by actual usage patterns and the contemplated low income expansion surcharge. A revised Exhibit 7 reflecting these changes will be supplied with the Amended Settlement.

In simple terms, if the Company were to propose a new average per kilowatt-hour distribution rate that reflected a percentage increase above the then-current average per kilowatt-hour distribution rate that is greater than the Cumulative GDPIPD Threshold

(Exhibit 7, Page 2, Line13, or equivalent to the Line B rate path), the Company would not be permitted to include its share of savings in the cost of service. If the proposed percentage increase is greater than the Cumulative Reopener Threshold (Exhibit 7, Page 2, Line 12, or the Line A rate path) but below the Cumulative GDPIPD Threshold, the Company would be required to re-prove the continued existence of savings. If the percentage increase is less than the Cumulative Reopener Threshold, the Company is allowed to maintain its share of savings.

Because the performance-based structure of the New Settlement continues the incentives for the Company to produce efficiencies and manage costs, the Company is encouraged to maximize the value from those incentives, and maintain distribution rates that fall below the Cumulative GDPIPD Threshold, in turn providing average distribution rates to customers that were at least as low in real terms as that which existed at the outset of the Original Settlement.

2. Second Savings Proof

Q. Would you please elaborate on the Second Proof of Savings with regard to the New Settlement?

A. As noted earlier, the Original Settlement contemplated a Second Proof of Savings would take place at the Company's first base rate change following the 2000-2004 rate freeze period with a backstop date of April 30, 2007 in the absence of a base rate change. The Second Savings Proof ultimately establishes the Company's share of total savings, and the Original Settlement contemplated that this analysis would be completed when customers could receive their share of total savings via a distribution rate review at the same time that the Company's share was ultimately determined. It was only in the event that if no cost of service had been filed by 2007, that the default provision required a separate shared savings filing by the Company. Because the New Settlement includes a cost of service for setting rates which provides for an immediate rate reduction and sharing of savings by customers, it establishes the cost of service for the Second Savings Proof as contemplated in the Original Settlement.

It is important to note that while the Company's share of savings has been set with the Second Savings Proof incorporated in the New Settlement, the Company must still perform at the agreed upon cost of service in order earn its full share. The setting of the Company's share is not a guarantee that the Company will earn its full share of savings, but merely an opportunity for the Company to earn that level through continued cost of service efficiencies. In addition, this Company opportunity to earn its full share of savings is further restricted by its ability to maintain distribution rates at a level lower than what customers could have reasonably expected their post-merger rate levels might have been in real terms pursuant to the reopener provisions discussed above.

<u>3. Shared Earnings</u>

Q. The Commission has expressed some concern over the five year average shared earnings provisions of the New Settlement. Would you please address these concerns?

A. Consistent with the provisions of the Original Settlement, the shared earnings calculation for the 2005-2009 rate freeze period of the New Settlement is to be calculated on a five year average. However, the New Settlement contained provisions which allowed for a potential return of accumulated customer shared earnings before the end of the rate freeze period. The shared earnings refund is a unilateral customer benefit in that it does not provide for any surcharge to customers if earnings are below 10.50%. Consequently, during the rate freeze period it is important that the calculation encompass an average return over the period in order to avoid increasing the economic risk to the Company by providing customer benefits for earnings above 10.50% in one year and having the Company assume all the risk of operating at an earnings level below 10.50% in the following year during a period in which the Company is unable to seek distribution rate adjustments.

However, in order to address the Commission's concerns regarding an annual review and refund of customers' portion of the shared earnings and interest on outstanding balances, the settling parties have agreed to the following modification in the procedure to credit customers. The Company will provide annual earnings reports by May 1st of the subsequent year and will return to customers their share of earnings subject to a deductible of $8 million. The deductible, which equals approximately 2% of return on equity, is intended to mitigate the Company's risk of over refunding as a result of a possible decline in the earnings that would be subject to sharing in subsequent years. Also, if, at the end of the 2005 – 2009 rate freeze period, the Company has over-refunded earnings to customers, the Company will be authorized to collect any such over-refund in 2010. Finally, any outstanding year-end balances of customers' share of earnings, which have not been refunded or which have been over refunded, and which are not scheduled for refund or surcharge in the following year shall accumulate interest at a rate equal to the then effective customer deposit rate.

Exhibit MDL–1 provides illustrations of these provisions for two scenarios. The first, on Page 1 of that exhibit, illustrates a period of assumed increasing Company earnings subject to sharing, and hence increasing credits to customers, during the rate freeze period. As can be seen in that illustration, customers receive refund credits annually, commencing in 2007, and they also accrue interest on the retained prior year balance each year. Illustration 2, shown on Page 2 of that Exhibit, depicts a period of diminishing Company earnings subject to sharing, and illustrates a customer refund credit applied in year 2007 for cumulative earnings in 2006 in excess of the allowed 10.50% which are offset by poor earnings in the years 2007 through 2009. In this example, customers received credits in excess of their share based on a five year average calculation and therefore the Company would be authorized to surcharge the over-refunded amount in 2010.

<u>4. Service Quality</u>

Q. Would you address the issues concerning the proposed Service Quality Plan provisions raised by the Commission?

A. Yes. The proposed Service Quality ("SQ") Plan provisions included in the New Settlement were intended simply to maintain the economics of the current SQ Plan and provide for any cumulative penalty balances at the end of the 2005-2009 rate freeze period to be refunded to customers in a manner to be determined by the Commission. Details of any new SQ Plan, with the exception of the potential penalties, offsets and timing of any refund, would be addressed in Commission Docket No. 3628. The current SQ Plan provides for both current-year penalty offsets as well as the carry forward of earned penalty offsets related to the four reliability standards into the subsequent year. Total annual penalties are currently capped at $2,400,000 with the potential for the doubling of this annual penalty cap. At the August 19, 2004 Commission open meeting, potential modifications to the SQ Plan economics were discussed. Specifically, the Commission suggested an annual rather than the five year cumulative review of the SQ Plan and penalties, the elimination of the carry forward of penalty offsets, an annual penalty cap equal to 1% of distribution revenues and an elimination of the penalty doubling provisions.

While the Company continues to believe that penalty offset mechanism, including the carry forward provisions, provide a continuing incentive to improve performance, as discussed in the response to Commission Data Request 1-67, the settling parties have agreed to amend the New Settlement to incorporate the modifications to the Company's SQ Plan as discussed above.

5. Storm Fund

Q. Would you please address the Commission's concerns regarding the Storm Fund and the Storm Fund balance?

A. The Company maintains a Storm Fund which is intended to provide the means to fund restoration efforts related to extraordinary storm events. The Fund is currently funded through base rate recoveries totaling $1,041,000 annually and in recent years with incremental pole attachment fee revenues as provided for in the Original Settlement. In addition, in the past the Company has used available funding sources outside of base rate revenues such as a 1996 transfer of a net $6.3 million of Demand Side Management surplus funds into the Storm Fund and a 1988 write-off of a $2.5 million Storm Fund deficit (see response to Commission Data Request 1-42). Storm Fund balances accrue interest on both positive and negative balances at a rate equal to ten year treasury bond rates, and as of June 30, 2004, the Storm Fund had a balance of $14,219,305.

Whether or not to cap the Storm Fund balance was an issue raised at the August 19, 2004 Commission Open Meeting. In the past, Rhode Island electric distribution company Storm Fund balances have included caps. As indicated in the response to Commission Data Request 1-42, the costliest storm to be charged to the Company's Storm Fund was Hurricane Bob, a category II hurricane that occurred in 1991. Incremental expense related to Hurricane Bob charged to the storm funds of Narragansett and the former Newport Electric Corporation totaled approximately $9.1 million, or approximately $11.4 million – $12.5 million in 2004 dollars. The extent of damage caused by any single severe storm depends in part on the frequency of such storms because the equipment, which tends to be susceptible to storm damage naturally ages during the periods between severe events. Because the Company's service territory has not encountered a storm anywhere near as severe as Hurricane Bob since 1991, a future hurricane could cause more damage than Hurricane Bob. In addition, a greater frequency of storms will also affect the need for resources in the fund. The devastation suffered to date in Florida during this year's extremely active hurricane season simply serves to highlight this potential for damage in the Company's service territory. As a result, we believe that the levels in the fund and the additions to it under the New Settlement remain reasonable.

However, Narragansett does not object to a Commission review of the issues either as part of the Settlement or in a future proceeding. As indicated in the response to Commission Data Request 3-6, the Company believes that a determination by the Commission to establish a cap on the Storm Fund balance would, in and of itself, not implicate any provisions in the New Settlement. Exhibit MDL-2 to this testimony is an estimate of the Company's Storm Fund balance at the end of the 2005 – 2009 proposed rate freeze period. As shown on that exhibit, assuming the Company's service territory experiences no storms eligible for Storm Fund reimbursement during the period, the fund balance is expected to be approximately $25.6 million at December 31, 2009. In the Division's response to Commission Data Request 1-28, the Division indicated that if the Storm Fund balance is approximately $20 million at December 31, 2009, the Division anticipates recommending suspending the accrual of Storm Fund collections at that time.

If the Commission deems it appropriate to set a cap on the Company's Storm Fund balance, the Company concurs with the Division's Storm Fund balance cap of $20 million as an appropriate level.

<u>6. Bill Format</u>

Q. Please discuss the Company's position related to the customer bill format regarding the option for Providence and East Providence to waive the implementation of the Customer Credit that would otherwise be applicable to customers in those communities in support of the undergrounding of the E-183 line.

A. The Customer Credit referred to here is related to customers' share of shared earnings, which have accrued during the rate freeze period of the Original Settlement. The New Settlement proposes to refund the cumulative customer shared earnings, estimated at $22.8 million, over the twelve months following the effective date of the New Settlement. In July 2004, legislation was passed that affords the cities of Providence and East Providence the right to waive the implementation of that credit to the Company's customers in those communities, and allows the Company to use the communities' respective share of the Customer Credit to support the undergrounding of the E-183 Line. The Commission expressed some concern over the bill format notifying customers in the event that such a waiver of the Customer Credit takes place. As indicated in the testimony of Ms. Lloyd, the Company is committed to working with the Commission in order to address its concerns with respect to this issue and will attempt to format the bill in a fashion the Commission deems appropriate, subject to the capabilities of the Company's billing system.

IV. CONCLUSION

Q. Does that conclude your testimony?

A. Yes it does.

Exhibit MDL-1

Exhibit MDL-1

Operation of Shared Earnings Refund Provisions

Narragansett Electric Company
Operation of Shared Earnings Refund Provisions
2005 - 2010
($000)

ILLUSTRATION 1

			2005	2006	2007	2008	2009	2010
1	Hypothetical Company Return On Equity Earned		12.00%	12.50%	12.75%	13.00%	13.00%	
2								
3	Projected Imputed Common Equity		266,300 (a)	270,295	274,349	278,464	282,641	
4	Cumulative Average Imputed Equity		266,300	268,297	270,314	272,352	274,410	
5								
6	Hypothetical Annual Income Available for Common Equity		31,956	33,787	34,979	36,200	36,743	
7	Cumulative Average Income Available for Common Equity		31,956	32,871	33,574	34,231	34,733	
8								
9	**Cumulative Average Return on Equity**		**12.00%**	**12.25%**	**12.42%**	**12.57%**	**12.66%**	
10								
11	Number of Years Multiplier		1	2	3	4	5	
12								
13	**Cumulative Shared Earnings**							
14	Cust Shared Earnings - 50/50 bandwidth		2,048	4,128	6,238	8,380	10,554	
15	Cust Shared Earnings - 75/25 bandwidth		1,536	4,644	8,608	13,450	18,364	
16	**Cumulative Customer Shared Earnings**		**3,585**	**8,771**	**14,847**	**21,830**	**28,919**	
17								
18	**Prior Period Interest @ Customer Deposit Rate**	**4.00%**						
19	Year-end 2005 Unreturned Balance Interest			143	143	143	143	
20	Year-end 2006 Unreturned Balance Interest				320	320	320	
21	Year-end 2007 Unreturned Balance Interest					320	320	
22	Year-end 2008 Unreturned Balance Interest						320	
23	**Cumulative Interest**			**143**	**463**	**783**	**1,103**	
24								
25	**Cumulative Customer Shared Earnings with Interest**		**3,585**	**8,915**	**15,310**	**22,613**	**30,022**	
26								
27	**Annual Deductible**		**8,000**	**8,000**	**8,000**	**8,000**	**-**	
28								
29	Cumulative Customer Shared Earnings with Interest After Deductible		-	915	7,310	14,613	30,022	
30								
31	**Refunds**							
32	2006 Refund			-	-	-	-	-
33	2007 Refund				915	915	915	915
34	2008 Refund					6,395	6,395	6,395
35	2009 Refund						7,304	7,304
36	2010 Refund							15,409
37	**Cumulative Earnings refund**		**-**	**-**	**915**	**7,310**	**14,613**	**30,022**
38								
39	Y/E Customer Earnings Share to be Refunded in Following Year		-	915	6,395	7,304	15,409	
40								
41	Y/E Unreturned Customer Earnings Share not Scheduled for Refund or Surcharge		3,585	8,000	8,000	8,000	-	

(a) Based on estimated imputed equity for 2005, and escalated at a rate of 1.5%. See 2005 cost of service provided with the response to Commission Data Request 1-91.

Narragansett Electric Company
Operation of Shared Earnings Refund Provisions
2005 - 2010
($000)

THE NARRAGANSETT ELECTRIC COMPANY
R.I.P.U.C. Docket No. 3617
Distribution Rate Plan Stipulation and Settlement
Witness: M.D. Laflamme
Exhibit MDL-1

ILLUSTRATION 2

			2005	**2006**	**2007**	**2008**	**2009**	**2010**
1	Hypothetical Company Return On Equity Earned		13.00%	12.00%	9.00%	8.00%	7.00%	
2								
3	Projected Imputed Common Equity		266,300 (a)	270,295	274,349	278,464	282,641	
4	Cumulative Average Imputed Equity		266,300	268,297	270,314	272,352	274,410	
5								
6	Hypothetical Annual Income Available for Common Equity		34,619	32,435	24,691	22,277	19,785	
7	Cumulative Average Income Available for Common Equity		34,619	33,527	30,582	28,506	26,762	
8								
9	**Cumulative Average Return on Equity**		**13.00%**	**12.50%**	**11.31%**	**10.47%**	**9.75%**	
10								
11	Number of Years Multiplier		1	2	3	4	5	
12								
13	**Cumulative Shared Earnings**							
14	Cust Shared Earnings - 50/50 bandwidth		2,048	4,128	5,053	-	-	
15	Cust Shared Earnings - 75/25 bandwidth		4,609	6,191	-	-	-	
16	**Cumulative Customer Shared Earnings**		**6,658**	**10,319**	**5,053**	**-**	**-**	
17								
18	**Prior Period Interest @ Customer Deposit Rate**	**4.00%**						
19	Year-end 2005 Unreturned Balance Interest			266	266	266	266	
20	Year-end 2006 Unreturned Balance Interest				320	320	320	
21	Year-end 2007 Unreturned Balance Interest					122	122	
22	Year-end 2008 Unreturned Balance Interest						(75)	
23	**Cumulative Interest**			**266**	**586**	**708**	**633**	
24								
25	**Cumulative Customer Shared Earnings with Interest**		**6,658**	**10,585**	**5,639**	**708**	**633**	
26								
27	**Annual Deductible**		**8,000**	**8,000**	**8,000**	**8,000**	**-**	
28								
29	Cumulative Customer Shared Earnings with Interest After Deductible		-	2,585	-	-	633	
30								
31	**Refunds**							
32	2006 Refund			-	-	-	-	-
33	2007 Refund				2,585	2,585	2,585	2,585
34	2008 Refund					-	-	-
35	2009 Refund						-	-
36	2010 Refund							(1,952)
37	**Cumulative Earnings refund**		**-**	**-**	**2,585**	**2,585**	**2,585**	**633**
38								
39	Y/E Customer Earnings Share to be Refunded in Following Year		-	2,585	-	-	(1,952)	
40								
41	Y/E Unreturned Customer Earnings Share not Scheduled for Refund or Surcharge		6,658	8,000	3,054	(1,877)	-	

(a) Based on estimated imputed equity for 2005, and escalated at a rate of 1.5%. See 2005 cost of service provided with the response to Commission Data Request 1-91.

Exhibit MDL-2

Exhibit MDL-2

Projected Storm Contingency Fund Balances

Projected Storm Contingency Fund Balances 2004 - 2009

YEAR	(1) BALANCE BEG OF MONTH		(2) ACCOUNT FUNDING	(3) INTEREST EXPENSE	(4) INTEREST INCOME	(5) DEDUCTIONS AS PAID	(6) BAL END OF MONTH	(7) RESERVE AMT (a) SUBJECT TO INT	(8) INT. RATE PERCENT (b)	(9) ACTUAL INTEREST
2004										
JAN	$13,412,960.87		$86,750.00	$49,467.47	$0.00	$0.00	$13,549,178.34	$13,369,585.87	4.440%	$49,467.47
FEB	13,549,178.34		86,750.00	49,971.47	0.00	0.00	13,685,899.81	13,505,803.34	4.440%	49,971.47
MAR	13,685,899.81		86,750.00	45,929.83	0.00	0.00	13,818,579.64	13,642,524.81	4.040%	45,929.83
APR	13,818,579.64		86,750.00	46,376.52	0.00	0.00	13,951,706.16	13,775,204.64	4.040%	46,376.52
MAY	13,951,706.16		86,750.00	46,824.71	0.00	0.00	14,085,280.87	13,908,331.16	4.040%	46,824.71
JUN	14,085,280.87		86,750.00	47,274.42	0.00	0.00	14,219,305.29	14,041,905.87	4.040%	47,274.42
JUL	14,219,305.29		86,750.00	47,725.63	0.00	0.00	14,353,780.92	14,175,930.29	4.040%	47,725.63
AUG	14,353,780.92		86,750.00	48,178.37	0.00	0.00	14,488,709.29	14,310,405.92	4.040%	48,178.37
SEP	14,488,709.29		86,750.00	48,632.63	0.00	0.00	14,624,091.92	14,445,334.29	4.040%	48,632.63
OCT	14,624,091.92		86,750.00	49,088.41	0.00	0.00	14,759,930.33	14,580,716.92	4.040%	49,088.41
NOV	14,759,930.33		86,750.00	49,545.74	0.00	0.00	14,896,226.07	14,716,555.33	4.040%	49,545.74
DEC	14,896,226.07		86,750.00	50,004.60	0.00	0.00	15,032,980.67	14,852,851.07	4.040%	50,004.60
DEC	15,032,980.67	(c)	213,000.00	0.00	0.00	0.00	15,245,980.67	0.00	4.040%	0.00
TOTAL			$1,254,000.00	$579,019.80	$0.00	$0.00				$579,019.80
2005										
JAN	$15,245,980.67		$86,750.00	$51,182.11	$0.00	$0.00	$15,383,912.78	$15,202,605.67	4.040%	$51,182.11
FEB	15,383,912.78		86,750.00	51,646.48	0.00	0.00	15,522,309.26	15,340,537.78	4.040%	51,646.48
MAR	15,522,309.26		86,750.00	52,112.41	0.00	0.00	15,661,171.67	15,478,934.26	4.040%	52,112.41
APR	15,661,171.67		86,750.00	52,579.92	0.00	0.00	15,800,501.59	15,617,796.67	4.040%	52,579.92
MAY	15,800,501.59		86,750.00	53,048.99	0.00	0.00	15,940,300.58	15,757,126.59	4.040%	53,048.99
JUN	15,940,300.58		86,750.00	53,519.65	0.00	0.00	16,080,570.23	15,896,925.58	4.040%	53,519.65
JUL	16,080,570.23		86,750.00	53,991.89	0.00	0.00	16,221,312.12	16,037,195.23	4.040%	53,991.89
AUG	16,221,312.12		86,750.00	54,465.72	0.00	0.00	16,362,527.84	16,177,937.12	4.040%	54,465.72
SEP	16,362,527.84		86,750.00	54,941.15	0.00	0.00	16,504,218.99	16,319,152.84	4.040%	54,941.15
OCT	16,504,218.99		86,750.00	55,418.17	0.00	0.00	16,646,387.16	16,460,843.99	4.040%	55,418.17
NOV	16,646,387.16		86,750.00	55,896.81	0.00	0.00	16,789,033.97	16,603,012.16	4.040%	55,896.81
DEC	16,789,033.97		86,750.00	56,377.05	0.00	0.00	16,932,161.02	16,745,658.97	4.040%	56,377.05
DEC	16,932,161.02	(c)	213,000.00	0.00	0.00	0.00	17,145,161.02	0.00	4.040%	0.00
TOTAL			$1,254,000.00	$645,180.35	$0.00	$0.00				$645,180.35

Projected Storm Contingency Fund Balances 2004 - 2009

YEAR	(1) BALANCE BEG OF MONTH		(2) ACCOUNT FUNDING	(3) INTEREST EXPENSE	(4) INTEREST INCOME	(5) DEDUCTIONS AS PAID	(6) BAL END OF MONTH	(7) RESERVE AMT (a) SUBJECT TO INT	(8) INT. RATE PERCENT (b)	(9) ACTUAL INTEREST
2006										
JAN	$17,145,161.02		$86,750.00	$57,576.01	$0.00	$0.00	$17,289,487.03	$17,101,786.02	4.040%	$57,576.01
FEB	17,289,487.03		86,750.00	58,061.91	0.00	0.00	17,434,298.94	17,246,112.03	4.040%	58,061.91
MAR	17,434,298.94		86,750.00	58,549.44	0.00	0.00	17,579,598.38	17,390,923.94	4.040%	58,549.44
APR	17,579,598.38		86,750.00	59,038.62	0.00	0.00	17,725,387.00	17,536,223.38	4.040%	59,038.62
MAY	17,725,387.00		86,750.00	59,529.44	0.00	0.00	17,871,666.44	17,682,012.00	4.040%	59,529.44
JUN	17,871,666.44		86,750.00	60,021.91	0.00	0.00	18,018,438.35	17,828,291.44	4.040%	60,021.91
JUL	18,018,438.35		86,750.00	60,516.05	0.00	0.00	18,165,704.40	17,975,063.35	4.040%	60,516.05
AUG	18,165,704.40		86,750.00	61,011.84	0.00	0.00	18,313,466.24	18,122,329.40	4.040%	61,011.84
SEP	18,313,466.24		86,750.00	61,509.31	0.00	0.00	18,461,725.55	18,270,091.24	4.040%	61,509.31
OCT	18,461,725.55		86,750.00	62,008.45	0.00	0.00	18,610,484.00	18,418,350.55	4.040%	62,008.45
NOV	18,610,484.00		86,750.00	62,509.27	0.00	0.00	18,759,743.27	18,567,109.00	4.040%	62,509.27
DEC	18,759,743.27		86,750.00	63,011.77	0.00	0.00	18,909,505.04	18,716,368.27	4.040%	63,011.77
DEC	18,909,505.04	(c)	213,000.00	0.00	0.00	0.00	19,122,505.04	0.00	4.040%	0.00
TOTAL			$1,254,000.00	$723,344.02	$0.00	$0.00				$723,344.02
2007										
JAN	$19,122,505.04		$86,750.00	$64,233.07	$0.00	$0.00	$19,273,488.11	$19,079,130.04	4.040%	$64,233.07
FEB	19,273,488.11		86,750.00	64,741.38	0.00	0.00	19,424,979.49	19,230,113.11	4.040%	64,741.38
MAR	19,424,979.49		86,750.00	65,251.40	0.00	0.00	19,576,980.89	19,381,604.49	4.040%	65,251.40
APR	19,576,980.89		86,750.00	65,763.14	0.00	0.00	19,729,494.03	19,533,605.89	4.040%	65,763.14
MAY	19,729,494.03		86,750.00	66,276.60	0.00	0.00	19,882,520.63	19,686,119.03	4.040%	66,276.60
JUN	19,882,520.63		86,750.00	66,791.79	0.00	0.00	20,036,062.42	19,839,145.63	4.040%	66,791.79
JUL	20,036,062.42		86,750.00	67,308.71	0.00	0.00	20,190,121.13	19,992,687.42	4.040%	67,308.71
AUG	20,190,121.13		86,750.00	67,827.38	0.00	0.00	20,344,698.51	20,146,746.13	4.040%	67,827.38
SEP	20,344,698.51		86,750.00	68,347.79	0.00	0.00	20,499,796.30	20,301,323.51	4.040%	68,347.79
OCT	20,499,796.30		86,750.00	68,869.95	0.00	0.00	20,655,416.25	20,456,421.30	4.040%	68,869.95
NOV	20,655,416.25		86,750.00	69,393.87	0.00	0.00	20,811,560.12	20,612,041.25	4.040%	69,393.87
DEC	20,811,560.12		86,750.00	69,919.56	0.00	0.00	20,968,229.68	20,768,185.12	4.040%	69,919.56
DEC	20,968,229.68	(c)	213,000.00	0.00	0.00	0.00	21,181,229.68	0.00	4.040%	0.00
TOTAL			$1,254,000.00	$804,724.64	$0.00	$0.00				$804,724.64

Projected Storm Contingency Fund Balances 2004 - 2009

YEAR	(1) BALANCE BEG OF MONTH		(2) ACCOUNT FUNDING	(3) INTEREST EXPENSE	(4) INTEREST INCOME	(5) DEDUCTIONS AS PAID	(6) BAL END OF MONTH	(7) RESERVE AMT (a) SUBJECT TO INT	(8) INT. RATE PERCENT (b)	(9) ACTUAL INTEREST
2008										
JAN	$21,181,229.68		$86,750.00	$71,164.11	$0.00	$0.00	$21,339,143.79	$21,137,854.68	4.040%	$71,164.11
FEB	21,339,143.79		86,750.00	71,695.75	0.00	0.00	21,497,589.54	21,295,768.79	4.040%	71,695.75
MAR	21,497,589.54		86,750.00	72,229.19	0.00	0.00	21,656,568.73	21,454,214.54	4.040%	72,229.19
APR	21,656,568.73		86,750.00	72,764.42	0.00	0.00	21,816,083.15	21,613,193.73	4.040%	72,764.42
MAY	21,816,083.15		86,750.00	73,301.45	0.00	0.00	21,976,134.60	21,772,708.15	4.040%	73,301.45
JUN	21,976,134.60		86,750.00	73,840.29	0.00	0.00	22,136,724.89	21,932,759.60	4.040%	73,840.29
JUL	22,136,724.89		86,750.00	74,380.94	0.00	0.00	22,297,855.83	22,093,349.89	4.040%	74,380.94
AUG	22,297,855.83		86,750.00	74,923.42	0.00	0.00	22,459,529.25	22,254,480.83	4.040%	74,923.42
SEP	22,459,529.25		86,750.00	75,467.72	0.00	0.00	22,621,746.97	22,416,154.25	4.040%	75,467.72
OCT	22,621,746.97		86,750.00	76,013.85	0.00	0.00	22,784,510.82	22,578,371.97	4.040%	76,013.85
NOV	22,784,510.82		86,750.00	76,561.82	0.00	0.00	22,947,822.64	22,741,135.82	4.040%	76,561.82
DEC	22,947,822.64		86,750.00	77,111.64	0.00	0.00	23,111,684.28	22,904,447.64	4.040%	77,111.64
DEC	23,111,684.28	(c)	213,000.00	0.00	0.00	0.00	23,324,684.28	0.00	4.040%	0.00
TOTAL			$1,254,000.00	$889,454.60	$0.00	$0.00				$889,454.60
2009										
JAN	$23,324,684.28		$86,750.00	$78,380.41	$0.00	$0.00	$23,489,814.69	$23,281,309.28	4.040%	$78,380.41
FEB	23,489,814.69		86,750.00	78,936.35	0.00	0.00	23,655,501.04	23,446,439.69	4.040%	78,936.35
MAR	23,655,501.04		86,750.00	79,494.16	0.00	0.00	23,821,745.20	23,612,126.04	4.040%	79,494.16
APR	23,821,745.20		86,750.00	80,053.85	0.00	0.00	23,988,549.05	23,778,370.20	4.040%	80,053.85
MAY	23,988,549.05		86,750.00	80,615.42	0.00	0.00	24,155,914.47	23,945,174.05	4.040%	80,615.42
JUN	24,155,914.47		86,750.00	81,178.88	0.00	0.00	24,323,843.35	24,112,539.47	4.040%	81,178.88
JUL	24,323,843.35		86,750.00	81,744.24	0.00	0.00	24,492,337.59	24,280,468.35	4.040%	81,744.24
AUG	24,492,337.59		86,750.00	82,311.51	0.00	0.00	24,661,399.10	24,448,962.59	4.040%	82,311.51
SEP	24,661,399.10		86,750.00	82,880.68	0.00	0.00	24,831,029.78	24,618,024.10	4.040%	82,880.68
OCT	24,831,029.78		86,750.00	83,451.77	0.00	0.00	25,001,231.55	24,787,654.78	4.040%	83,451.77
NOV	25,001,231.55		86,750.00	84,024.78	0.00	0.00	25,172,006.33	24,957,856.55	4.040%	84,024.78
DEC	25,172,006.33		86,750.00	84,599.73	0.00	0.00	25,343,356.06	25,128,631.33	4.040%	84,599.73
DEC	25,343,356.06	(c)	213,000.00	0.00	0.00	0.00	25,556,356.06	0.00	4.040%	0.00
TOTAL			$1,254,000.00	$977,671.78	$0.00	$0.00				$977,671.78

Notes:

(a) Reserve Amt (Column 7) = Beg Balance (Column 1) minus 1/2 x prior month's Funding (Column 2) plus 1/2 x current month's Storm Deductions (Column 5), a one month lag.

(b) Interest Rate (Column 8) held constant at March 2004 adjusted rate of 4.04%.

(c) From 2004 through 2009, December includes an additional funding value (Column 2) reflecting estimated annual pole attachment revenues of $213K based on the three year average of revenues collected from 2001 to 2003.

Testimony of
Jeanne A. Lloyd

DIRECT TESTIMONY

OF

JEANNE A. LLOYD

Table of Contents

I. <u>INTRODUCTION AND QUALIFICATIONS</u>

Q. Please state your full name and business address.

A. Jeanne A. Lloyd, 55 Bearfoot Road, Northborough, Massachusetts 01532.

Q. Please state your position.

A. I am a Principal Financial Analyst in the Distribution Regulatory Services Department of National Grid USA Service Company, Inc. The Distribution Regulatory Services Department provides rate related support to The Narragansett Electric Company ("Narragansett" or "Company").

Q. Please describe your educational background and training.

A. In 1980, I graduated from Bradley University in Peoria, Illinois with a Bachelor's Degree in English. In December 1982, I received a Master of Arts Degree in Economics from Northern Illinois University in De Kalb, Illinois.

Q. Please describe your professional experience?

A. I was employed by EUA Service Corporation ("EUA") in December 1990 as an Analyst in the Rate Department. I was promoted to Senior Rate Analyst on January 1, 1993. My responsibilities included the study, analysis and design of the retail electric service rates, rate riders and special contracts for the EUA retail companies. I assumed my present position after the merger of New England Electric System and Eastern Utilities Associates in April 2000. Prior to my employment at EUA, I was on the staff of the Missouri Public Service Commission in Jefferson City, Missouri in the position of research economist. My responsibilities included presenting both written and oral testimony before the Missouri Commission in the areas of cost of service and rate design for electric and natural gas rate proceedings.

Q. Have you previously testified before the Rhode Island Public Utilities Commission ("Commission")?

A. Yes.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe the structure and design of the distribution rates proposed in the Distribution Rate Plan Stipulation and Settlement ("Settlement") filed on June 29, 2004 by the Company and other parties to the Settlement ("Parties").

Q. How is your testimony organized?

A. My testimony begins with a description of the structure of the Company's current distribution rates and the proposed structure and rates. Next, I discuss the tariff and rate design changes necessary to accommodate certain amendments to the Settlement. My testimony then presents the impact of the proposed distribution rate changes, including the effect of the proposed amendments, using typical bill comparisons. The next section of my testimony describes changes to certain of the Company's adjustment clause provisions and also describes the proposed Customer Credit Provision and how the Company proposes to present the Customer Credit on customers' bills.

III. RATE DESIGN

Q. Please summarize the proposed distribution rates included in Exhibit 5 of the Settlement.

A. Under the proposed distribution rate structure in the Settlement, the Company would:

1. Consolidate the current twenty-six rate classes into twelve rate classes. Currently, the Company has five residential rate classes, eighteen general service rate classes and three streetlighting rate classes. The Settlement proposal would reduce that number to three residential rate classes, nine general service rate classes, including two Backup Service rate classes, and two streetlighting rate classes. Exhibit 5, pages 1 and 2, shows the proposed mapping of the present rate classes to the proposed rate classes.
2. Withdraw the following tariffs:
    a) Residential Water Heater Control Rate A-18;
    b) Residential Time-of-Use Rate A-32;
    c) 69 kV Rate N-01;
    d) High Voltage Rate H-72;
    e) Small C&I Backup Service Rate B-06;
    f) General C&I Backup Service Rate B-02;
    g) High Voltage Backup Service Rate B-72; and
    h) Auxiliary Service Provision.
3. Transition the distribution rates for the Limited Traffic Signal Rate R-02 to those of the Small C&I Rate C-06 over a five-year period, and ultimately transfer Rate R-02 customers to Rate C-06 and withdraw Rate R-02.
4. Transition the distribution rates for the Limited All-Electric Living Rate T-06 to those of the Basic Residential Rate A-16 or the Small C&I Rate C-06, as applicable, over a five-year period, and ultimately transfer Rate T-06 customers to either Rate A-16 or Rate C-06, as appropriate, and withdraw Rate T-06.

5. Transition the distribution rates for the Residential Storage Heating Rate E-30 to those of the Basic Residential Rate A-16 over a five-year period, and ultimately transfer Rate E-30 customers to Rate A-16 and withdraw Rate E-30.
6. Redesign the Low Income Rate A-60 to include inclining block kWh charges to encourage more efficient energy usage.
7. Redesign the Company's general service rates to:
    - increase demand charges and correspondingly reduce energy charges to reflect the nature of distribution system costs;
    - increase power factor billing threshold from 80% to 90% effective January 2006; and
    - simplify the billing demand calculation.
8. Redesign the Backup Service rates, Rate B-32 and Rate B-62.

The Company is proposing the above-described consolidation and elimination of rate classes, as well as redefining billing structures, in order to simplify its distribution rates for its customers, simplify administration and billing of all its rates and charges, and to reflect the changing needs and benefits that had previously been provided through older rate classes that, under current circumstances, have outlived their usefulness. These proposals as well as the specific design for each rate class are discussed in more detail below.

<u>Residential Rates</u>

Q. Please describe Narragansett's current residential rates.

A. Narragansett currently has five residential rates – Rates A-16, A-18, A-32, A-60 and E-30. In addition, approximately 190 residential customers also take service on Rate T-06.

Service under the Basic Residential Rate A-16 is available for service to residential customers in individual dwellings, farms and churches.

The Low Income Rate A-60 provides a discount from the Residential Service Rate A-16 for customers receiving Supplemental Security Income from the Social Security Administration, or who are eligible for the low-income home energy assistance program or one of the following from the appropriate Rhode Island agencies: Medicaid, Food Stamps, General Public Assistance or the Family Independence Program.

The Water Heater Control Rate A-18 is applicable to customers with electric water heating who are willing to have a control device placed on their water heaters. The rate has been closed to new customers since January 1, 1998. Participating customers receive a credit of $0.00661 per kWh for the first 750 kWh used per month. During 2002 and 2003, meters were installed on each customer's service to enable automated meter reading and the water heater control device was removed from all but approximately 4,000 customers who are participating in the Company's Home Energy Management ("HEM") Program, an energy efficiency program that has been offered by the Company through its Demand Side Management Programs. Although the controls have been removed from meters of non-HEM Program customers, the Company has continued to provide the credit to all customers receiving delivery service on Rate A-18 in accordance with the currently effective tariff.

The Time-of-Use Rate A-32 is mandatory for all customers having kWh deliveries exceeding 30,000 kWh per year and optional to customers with usage exceeding 6,000 kWh per year. Although designated as a time-of-use rate, the time-differentiated charges were eliminated in the Company's Rate Unbundling Filing, Docket No. 2515 in July 1997. There are approximately 2,500 customers presently taking service on this rate.

The Storage Heating Rate E-30 is an incentive rate which was designed specifically to encourage the installation of electric thermal storage (ETS) systems by subsidizing the incremental costs of these systems through the rate design. Currently, there are thirteen customers on this rate which was closed to new customers effective July 1, 1990.

The Limited All-Electric Service Rate T-06 is a rate for residential apartments, houses, motels, hospitals, nursing homes and schools whose sole source of energy is electricity. The rate was closed for service to new customers effective May 1, 1984. There are approximately 190 residential customers taking service on Rate T-06 and approximately 75 commercial customers.

Q. Please describe Narragansett's approach to rate design for the residential rates for retail delivery service.

A. The Company is proposing to consolidate its existing five residential classes into two by the end of the Rate Freeze period (December 31, 2009)– Basic Residential Rate A-16 and Residential Low Income Rate A-60. Customers presently taking service on Rates A-18 and A-32 will be transferred to Rate A-16. Distribution rates for customers served on

Rate E-30 and residential customers served on Rate T-06 will be "phased-in" over five years to ultimately equal the distribution rates under Rate A-16 in 2009, and these customers will at that time be transferred to Rate A-16, and Rates E-30 and T-06 will be withdrawn.

Q. Why is the Company proposing to consolidate the residential rate classes listed above?

A. The purpose of consolidating the five residential rate classes into two includes not only rate simplicity but also the applicability of rates. Many of these rates have been closed to new customers for years and the original purpose of the rate no longer applies. For example, Rate A-32, the time-of-use rate class, no longer contains time-of-use pricing. Therefore, there no longer appears to be a basis for continuing to offer this rate. Rate A-18, the controlled water heater rate, provides the same service as Rate A-16, and the benefits of controlled water heating are significantly less today than when the Company, through its affiliate New England Power Company, was in the generation business. Further, with the exception of customers participating in the HEM Program, the Company no longer controls the water heaters of Rate A-18 customers. Therefore, transferring these customers to Rate A-16 appears to be the appropriate treatment.

Q. Please describe the proposed rate design for Rate A-16.

A. The proposed rate design for Rate A-16 is provided in Exhibit 5, Page 5. In Section 1 of Page 5, Columns (a) and (b) show the billing units and present revenues, respectively, of the proposed combined rate class. Columns (c) and (d) show the rate year billing units and proposed distribution charges as calculated in Section 2 of Page 5. Column (e) shows the proposed revenues. Columns (f) and (g) show the revenue change and the percentage of revenue change for each of the present rate classes and for the proposed combined class.

Section 2 shows the calculation of the proposed charges. The Company begins with a revenue requirement calculated in Exhibit 3 for the combined rate class identified above. The customer charge has been increased to $2.75 from its current level of $2.54, and is applicable to all customers except Low Income customers currently receiving delivery service on Rate A-60.

Since the revenue requirement for Rate A-60 is reflected in that of Rate A-16, and the design of the Rate A-60 charges is dependent upon the design of the Rate A-16 charges, as described below, the revenue generated under the proposed Rate A-60 charges is also reflected in the Rate A-16 rate design to arrive at the remaining revenue requirement to be recovered by the distribution energy charges. The distribution energy charges for each year through 2009 are calculated on page 6 of Exhibit 5. The distribution energy charges for Rate A-16 reflect the effect of estimated incremental distribution revenue to be generated by the distribution charges for Rates E-30 and T-06 as they are transitioned to Rate A-16 over the five-year period.

Q. Why is the Company proposing to transition or “phase-in” Rates E-30 and T-06 to Rate A-16 rather than immediately transfer customers on these rates to Rate A-16 upon approval of the Settlement?

A. Narragansett has examined the effect of moving customers receiving service under Rate E-30 and T-06 onto Rate A-16. The Company has estimated that the bill impacts to these customers from the proposed Rate A-16 distribution charges would be relatively significant. Thus, Narragansett proposes to maintain these rate classes at this time. The Company is proposing a five-year transition period where the distribution charges to customers on Rate E-30 and Rate T-06 increase each year until they equal to the distribution charges of Rate A-16.

Q. Please describe the calculation of the proposed "phased-in" charges applicable to Rates E-30 and T-06 and those applicable to Rates A-16 and A-60.

A. The design of the "phased-in" charge is shown in Exhibit 5, page 6. The proposed customer charge applicable to Rates E-30 and T-06 is set at the Rate A-16 proposed customer charge of $2.75 per month. The next step, shown in lines 3 through 6 for Rate E-30 and lines 16 through 19 for Rate T-06, is to calculate the difference between the proposed Rate A-16 distribution energy charge and the current distribution energy charge for each of these rates. This difference is divided by five, the number of years in the transition period. The resulting value is then added to the prior year's distribution energy charge to calculate the distribution energy charge for the current year until the distribution energy charge for each of these rate classes equals the proposed distribution energy charge for Rate A-16.

Once the annual distribution energy charges for Rate E-30 and Rate T-06 have been developed, the estimated incremental revenue generated by each rate class in each year is calculated. This incremental revenue is then used to reduce the distribution energy charge for Rate A-16 in each year until the distribution energy charges for Rates E-30, T-06 and A-16 converge in the final year.

Low Income Rate A-60

Q. What is the Company's proposed rate design for Rate A-60?

A. The Company is proposing to continue to provide discounted distribution charges to customers receiving service under this rate. The present Rate A-60 distribution charges provide a discount of approximately 50% from the Rate A-16 distribution charges, and the proposed distribution charges will maintain approximately that same discount level. The estimated ongoing annual subsidy generated from the proposed distribution charges is approximately $3.5 million.

The proposed Rate A-60 distribution charges have been redesigned to encourage more efficient energy consumption. The customer charge is set at $0, as it is today. However, in a change from the current rate structure, the Company is not proposing a discounted rate for all kWhs delivered. Rather, the Company has proposed a two block structure where the distribution energy charge for the first 500 kWh per month ("initial block") reflects the entire discount and is based on the rate for the kWh in excess of the first 500 kWh per month ("tail block"). The Company chose the first 500 kWh as the initial block as 500 kWh represents the approximate average of monthly kWh deliveries for customers on Rate A-60. The tail block rate which is applied to monthly usage in excess of 500 kWh is set equal to the Rate A-16 distribution kWh charge.

In addition, the zonal charges currently applicable to customers of former Blackstone Valley Electric Company ("Blackstone") and Newport Electric Corporation ("Newport") have been eliminated. These charges were implemented in May 2000 in Docket No. 2930 as a "hold harmless" measure for the low income customers who would have been negatively impacted by transferring to Narragansett's Rate A-60 at that time.

<u>General Service Rates</u>

Q. Please describe Narragansett's current general service rate classes.

A. Narragansett currently has eighteen general service rate classes. Several of these rate classes have been closed to new customers for several years and the original justification for some of these rate classes has long since ended. As described below, Narragansett proposes to eliminate some of its current rate classes and consolidate customers onto a smaller number of up-to-date rate classes.

Summary of the Current General Service Rate Classes:

The Small C&I Rate C-06 is available for small commercial and industrial customers whose demand does not exceed 10 kW.

The General C&I Rate G-02 is a demand-based rate available for general service customers with average demands greater than 10 kW but less than 200 kW.

The 200 kW Demand Rate G-32 is mandatory for customers with average demands exceeding 200 kW and voluntary for customers below 200 kW.

The 3000 kW Demand Rate G-62 is mandatory for customers with average demands exceeding 3,000 kW and voluntary for customers below that level.

The Limited Medium Secondary Voltage C&I Rate G-22 is closed to new customers and is limited to former customers of Blackstone and Newport that had been served under those companies' medium general service Rate G-2 tariffs. Rate G-22 was implemented as one of the rate design provisions of the settlement in Docket No. 2930 as a way to limit the bill impacts to those customers that would have been negatively impacted by immediately transferring to one of Narragansett's general service rates. There are presently approximately 2600 customers receiving service under this rate.

The Storage Cooling Rate E-40 was originally designed as a marginally priced conservation and load management rate for customers that install a full storage air conditioning system designed so that no operation of the chiller or compressor will be required for a period of six consecutive hours between the hours of 9 a.m. and 6 p.m. during the months of June through September. There are presently 15 customers receiving service on this rate. Usage billed under the provisions of Rate E-40 is separately metered and the customer's primary service usage is billed under one of the Company's general service rates.

The Business Space Heating Rate V-02 is available to commercial customers with electric space heating and has been closed to new customers since May 1, 1984. As with Rate E-40, usage billed under this rate is separately metered from the customer's primary service usage. There are presently approximately 275 customers receiving service on this rate.

The Limited Traffic Signal Rate R-02 is available to the State of Rhode Island or any city or town for the operation of traffic signals and has been closed to new customers since May 10, 1992.

The Limited All-Electric Service Rate T-06 is a rate for residential apartments, houses, motels, hospitals, nursing homes and schools whose sole source of energy is electricity. The rate was closed for service to new customers effective May 1, 1984. There are 75 commercial customers taking service on this rate.

The Electric Propulsion Rate X-01 is applicable to any customer taking service for traction power at voltages of 69kV or greater. Only one customer is presently served on Rate X-01.

The 69kV Rate N-01 is available to customers taking service at a voltage level of 69 kV or greater and is mandatory for the United States Navy ("Navy"). Pursuant to the Commission's order in Docket No. 3551, the Navy would be transferred to Rate G-62 effective January 1, 2005. Once the Navy has transferred to Rate G-62, there will be no customers taking service on Rate N-01.

The Station Power Delivery and Reliability Rate M-1 is available to merchant generators for station power service. There are three customers taking service on this rate.

The High Voltage Rate H-72 was originally developed in connection with a proposal to service the single customer now taking service under Electric Propulsion Rate X-01. The rate applies to customers with demands of 200 kW or greater that take delivery service at 69 kV or greater. There are no customers receiving service on this rate.

The Small C&I Backup Service Rate B-06 is available to customers that receive all or part of their energy requirements from non-emergency generation units and would otherwise be served on Rate C-06. There are no customers receiving service on this rate.

The General C&I Backup Service Rate B-02 is available to customers that receive all or part of their energy requirements from non-emergency generation units and would otherwise be served on Rate G-02. There are no customers receiving service on this rate.

The 200kW Demand Rate B-32 is available to customers that receive all or part of their energy requirements from non-emergency generation units and would otherwise be served on Rate G-32. There are no customers receiving service on this rate.

The High Voltage Backup Service Rate B-72 is available to customers that receive all or part of their energy requirements from non-emergency generation units and would otherwise be served on Rate H-72. There are no customers receiving service on this rate.

The 3,000 kW Demand Rate B-62 is available to customers that receive all or part of their energy requirements from non-emergency generation units and would otherwise be served on Rate G-62. There are two customers taking service on this rate.

In addition, the Company presently has an Auxiliary Service Provision applicable to customers who generate all or part of their energy requirements from generation units installed prior to April 1, 1998. Service under the Auxiliary Service Provision is "grandfathered" through the end of the Rate Freeze Period (December 31, 2004) pursuant to Section 5(b) of the settlement in Docket No. 2930.

Q. What is the Company's proposal under the Settlement for the structure of the general service rate classes?

A. The Company is proposing to consolidate its existing general service rate classes into six rate classes: four general service classes – Small C&I Rate C-06, General C&I Rate G-02, 200 kW Demand Rate G-32 and 3,000 kW Demand Rate G-62, and two backup service rate classes – C&I Backup Service Rate B-32 and 3,000 kW Demand Backup Service Rate B-62. Rate X-01 and Rate M-1 will be retained. In addition, as an amendment to the Settlement, the Company is proposing to close Storage Cooling Rate

E-40 to new customers, but maintain the rate for a period of two years. This proposal will be discussed in more detail below.

Narragansett is proposing to withdraw Rates G-22, V-02, H-72, N-01, B-02, B-06 and B-72. Customers on Rate G-22 will be transferred to either Rate G-02 or Rate G-32 depending on their usage characteristics. Customers taking service on Rate V-02 will be transferred to the customer's primary service rate (the rate class under which the customer receives retail delivery service for the rest of its electric delivery needs). Commercial customers taking service on Rate T-06 and customers on Rate R-02 will be transferred to Rate C-06 in 2009 at the end of a five-year transitional period.

No customers will be affected by the withdrawal of Rates H-72, B-02, B-06 or B-72 since no customers are presently receiving service on any of these rates. Under the Settlement, and consistent with the Commission's order in Docket No. 3551, the Navy will be transferred to Rate G-62, leaving no customers on Rate N-01.

The distribution charges to Electric Propulsion Rate X-01 and Station Power Delivery and Reliability Rate M-1 have been decreased by the percentage decreases applicable to each class as shown in Exhibit 3 of the Settlement.

Q. Please describe the proposed distribution rate designs for the general services rates.

A. The design of the proposed general service distribution rates is shown in Exhibit 5, pages 8 through 23 and is described below.

Small C&I Rate C-06

The design of the Small C&I Rate C-06 distribution rates is shown on Exhibit 5, pages 8 and 9. The monthly customer charge has been increased to $6.00 per month from its current level of $5.73. The revenue requirement for Rate C-06 includes the revenue requirement for Rate T-06 for commercial customers and a proportionate share of the revenue requirement for Rate E-40 and Rate V-02, as shown on pages 21 and 22 of Exhibit 5. The total revenue requirement is reduced by the revenue generated from the customer charge, and the remaining revenue requirement is collected in the distribution energy charge. The distribution energy charges for Rate C-06, as well as Rates R-02 and T-06, are calculated on page 9 in the same manner as the "phased-in" charges for Rates A-16, E-30 and T-06 (residential) described above.

General C&I Rate G-02

For General C&I Rate G-02, the Company proposes to keep the customer charge at its current level of $103.41 and increase the distribution demand charge from its present level of $2.91 per kW to $3.23 per kW. The revenue requirement for Rate G-02 includes a proportionate share of the revenue requirement for Rate E-40, Rate V-02, and Rate G-22 as shown on pages 21, 22 and 23 of Exhibit 5. The total revenue requirement is reduced by the revenue generated from the customer charge and proposed distribution demand charge, and the remaining revenue requirement is divided by the rate year kWh deliveries to arrive at the proposed distribution energy charge. The proposed rate design for Rate G-02 is shown in Exhibit 5, page 10.

<u>200 kW Demand Rate G-32 and 3,000kW Demand Rate G-62</u>

For 200 kW Demand Rate G-32, the Company proposes to keep the customer charge at its current level of $236.43 and increase the distribution demand charge from its present level of $1.56 per kW to $2.09 per kW. The revenue requirement for Rate G-32 includes a proportionate share of the revenue requirement for Rate E-40 and Rate G-22, as shown on pages 22 and 23 of Exhibit 5. The revenue requirement is reduced by the revenue generated from the customer charge and proposed distribution demand charge, and the remaining revenue requirement is divided by the rate year kWh deliveries to arrive at the proposed distribution energy charge. The G-32 rate design is shown in Exhibit 5, page 12.

The revenue requirement for the 3,000 kW Demand Rate G-62 is based on the present revenues and kWh deliveries Rates B-62, G-62 and N-01. The Company is proposing to keep the monthly customer charge at its present level of $17,118.72 and collect the entire revenue requirement through the proposed distribution demand charge by increasing the distribution demand charge from its present level of $0.75 per kW to $2.34 per kW. The Rate G-62 rate design is shown in Exhibit 5, page 18.

Q. Are there any other proposed changes to the general service rate classes?

A. Yes. First, the Company is proposing to simplify the billing demand provisions for Rate G-32 and Rate G-62. The Company has removed all references to shoulder hours, and peak hours now include those hours presently defined as the shoulder period. In addition, the Company is proposing to simplify the definition of billing demand as: a) the greatest 15-minute peak occurring in the peak period as measured in kW, b) 80% of the greatest 15-minute peak occurring during the peak period as measured in kVA, or c) 75% of the greatest demand as determined in a) and b) over the preceding eleven months. The Company is proposing to eliminate from the determination of billing demand the following criteria: 50% of the greatest 15-minute peak occurring is such month during off-peak hours as measured in kW, or 40% of the greatest 15-minute peak occurring in such month during off-peak hours as measured in kVA.

Second, the Company is proposing to change the power factor in the determination of billing demand. For customers on Rate G-02, Rate G-32 and Rate G-62 with average annual demands that exceed 75 kW, the Company meters both kW and kVA. Today, the customers' billing demand is based on the greater of the fifteen-minute peak as measured in kW or 80% of the fifteen-minute peak as measure in kVA. The Company is proposing to increase the kVA threshold to 90% of the greatest fifteen-minute peak as measured in kVA effective with the first billing cycle in January 2006. For purposes of designing the distribution demand charges, an adjustment to the class billing demand has been made to reflect an increase in billing units as a result of this change. The revised demand charge calculations for Rates G-02, G-32 and G-62 reflecting a 90% power factor are shown on pages 11, 14 and 19 of Exhibit 5, respectively.

<u>Backup Service Rates</u>

Q. Please describe the Company's proposed Backup Service rates.

A. The Company is proposing two Backup Service rates. Rate B-62 is applicable to customers who generate all or part of their energy requirements and who would otherwise take service on the Company's Rate G-62 3000 kW Demand Rate. Rate B-32 is proposed to be applicable to all other Backup Service customers.

The backup charges will consist of a monthly customer charge identical to the customer charges of the companion general service rate classes (Rate G-32 and Rate G-62), and a Backup Service distribution demand charge. The Backup Service distribution energy charge and the Backup Service transmission charges contained in the current tariffs have been eliminated.

The distribution demand charge is designed to collect, after consideration of the customer charge, the remaining distribution revenue requirement attributable to the provision of Backup Service. For Rate G-32, the backup distribution demand charge is proposed at $5.33 per kW and for Rate G-62, the backup distribution demand charge is proposed at $2.34 per kW.

Currently, a customer's Backup Service demand is based on a contract demand which represents the customer's generation capacity. This contract demand is billed every month at the current Backup Service distribution demand charge, regardless of the customer's actual generation. Under the Settlement, the Company is proposing to base Backup Service demand on the customer's actual metered generation at the time of the maximum 15-minute coincident demand of both the generation unit(s) and from the meter(s) at the Customers' service entrance(s) occurring during peak hours.

As today, supplemental usage will be billed at the applicable general service rates.

Auxiliary Service Customers

Q. Please describe the Auxiliary Service customers.

A. Customers with generation units installed prior to April 1998 are exempt from the Backup Service rates under the Company's current Backup Service tariffs. Section 5(b) of the settlement approved in Docket No. 2930 specified that these customers would be "grandfathered" under the Company's Auxiliary Service Provision through the end of the Rate Freeze period (December 31, 2004).

Q. What is the Company's proposal with regard to Backup Service billing for the Auxiliary Service customers?

A. The Company is proposing to "phase-in" Backup Service rates for the Auxiliary Service customers in a manner similar to the phase-in proposals described above for Rates E-30, T-06 and R-02. The design of the "phased-in" charges for Rate B-32 is shown in Exhibit 5, pages 14 and 15 and charges for Rate B-62 are calculated on pages 19 and 20.

Streetlighting

Q. How does Narragansett propose to treat the streetlighting rates in this proceeding?

A. The Company is proposing to maintain Limited Private Lighting Rate S-10 and General Streetlighting Rate S-14. The Company is proposing to withdraw Limited Streetlighting Service Rate S-12, which is currently closed to new customers, and move existing customers receiving retail delivery service under this rate to Rate S-14. The Company is proposing to establish specific charges currently included in Rate S-12 in the tariff for Rate S-14. These new Rate S-14 charges are for poles and luminaires offered under Rate S-12 that are currently not offered on Rate S-14.

The Company is also proposing to maintain at their currently effective levels the zonal credits applicable to former Blackstone and Newport streetlighting customers which were implemented as part of the settlement in Docket No. 2930.

Q. How has the Company designed the proposed Rate S-10 and Rate S-14 charges?

A. To collect the revenue requirement from the streetlighting rates, the Company is proposing to set the luminaire and pole charges at the currently effective levels and to eliminate the distribution energy charge. The proposed streetlighting rate design is shown in Exhibit 5, pages 24 through 26.

IV. AMENDMENTS TO THE SETTLEMENT

Q. What amendments have the Parties proposed to the Settlement as filed on June 29, 2004?

A. All of the proposed amendments to the Settlement are discussed in detail in the testimony of Mr. Gavilondo. Two of the amendments will require revisions to the Company's proposed tariffs and rate design proposals. Specifically, the Parties are proposing to: 1) close Rate E-40 to new customers but maintain the rate, with its current charges, through 2006; and 2) end the operation of the HEM Program and end the water heater control credits applicable to these customers.

Changes to the tariffs and rate design necessary to accommodate these amendments are discussed below and the revised tariffs and Settlement Exhibits will be included in the Company's amended settlement filing on September 17, 2004.

Q. Please describe the proposed amendments for Storage Cooling Rate E-40.

A. Presently, fifteen customers receive delivery service on Rate E-40. The Parties are proposing to close this rate class to new customers and maintain the rate, with its current charges, through 2006. Customers receiving delivery service on this rate will have the option of moving to either Rate G-32 or Rate G-02, whichever is applicable, any time prior to January 1, 2007, if they so choose. If a customer chooses this option, the customer will be required to pay for the necessary rewiring and metering changes. Customers choosing to remain on Rate E-40 will be transferred to the appropriate general service rate effective with the first billing cycle in January 2007.

The Parties are proposing no changes to proposed distribution charges of Rates G-02 and G-32 as a result of this amendment.

Q. What tariff and rate design changes are necessary to end the operation of the HEM Program?

A. The Company will eliminate in the Rate A-16 tariff the water heater control credit that was originally proposed to continue. In addition, the annual distribution energy charge for Rate A-16 has been redesigned to eliminate the credit associated with the HEM customers, which results in a small reduction in the annual distribution energy charge.

V. TYPICAL BILL ANALYSIS

Q. Has the Company prepared a typical bill analysis showing the bill impacts of the proposed distribution rate changes?

A. Yes. Exhibit 6 of the Settlement contains the Company's typical bill analysis showing the impact of the originally-proposed distribution rates for each of the Company's current rate classes. The bill impacts for each customer presently on Rate G-22, Rate E-40 and Rate V-02 have been calculated based on each customer's combined general service usage and supplemental rate usage, since usage under these rate classes is separately metered. The Company has also included the bill impacts on the existing Rate B-62 customers as a result of the proposed Backup Service rates. These bill impacts are meant to represent the impact that the customers are likely to see as a result of the distribution rates implemented on the effective date of the Settlement, and therefore, the typical bills also include the Customer Credit.

VI. TARIFFS AND COVER SHEETS

Q. Has the Company included the proposed tariffs and cover sheets?

A. The originally proposed tariffs and cover sheets are included as Settlement Exhibit 2.

Q. Does the Company have any revisions to the tariffs presented in Exhibit 2?

A. In addition to changes required by the amendments to the Settlement described above, there are a number of minor corrections to the tariffs as originally filed. These revisions will be incorporated in the Company's amended Settlement filing on September 17, 2004. To facilitate the review of these changes, a copy of the revised tariff pages, marked to show changes, will be included with the Company's amended filing.

VII. ADJUSTMENT PROVISIONS

Q. Does Narragansett propose to make any changes to its adjustment provisions?

A. Yes. The Company is proposing to make changes to the Non-Bypassable Transition Charge Adjustment Provision and the Transmission Service Cost Adjustment Provision. The revisions to these adjustment provisions are necessary to eliminate references to provisions implemented during the Rate Freeze period pursuant to the settlement in Docket No. 2930 that are no longer applicable. The Company is also proposing a new provision, the Customer Credit Provision.

Non-Bypassable Transition Charge Adjustment Provision

The revised Non-Bypassable Transition Charge Adjustment Provision is shown in Exhibit 2, page 112. The current provision allows for separate transition charges, should conditions require them pursuant to Section 15 of the settlement in Docket No. 2930, through the end of the Rate Freeze period for the pre-merger Narragansett, Blackstone and Newport. The provision has been revised to eliminate the description of the calculation of charges applicable to the former retail companies.

<u>Transmission Service Cost Adjustment Provision</u>

The Transmission Service Cost Adjustment Provision has been revised to eliminate references to zonal charges relating to former Blackstone and Newport. The revised provision is shown in Exhibit 2, page 113.

<u>Customer Credit Provision</u>

Q. Please describe the Customer Credit Provision contained in Exhibit 2, page 114.

A. The proposed Customer Credit Provision, R.I.P.U.C. No. 1185, specifies the methodology agreed to by the Parties to refund to customers their share of excess earnings accrued on behalf of customers pursuant to Section 11(A) of the settlement approved by the Commission in Docket No. 2930. The provision also allows for the cities of Providence and East Providence to waive the assessment of the credit on bills to customers in these cities and to apply the funds that would otherwise have been credited to these customers to the cost of undergrounding the E-183 line as described in the settlement approved by the Energy Facilities Siting Board on May 28, 2004 in Docket SB-2003-1 and the recently enacted legislation creating R.I.G.L. 42-98-1.1.

Q. How will the Customer Credit appear on customers' bills?

A. For all customers (with the exception of customers in Providence and East Providence should the city councils ratify such waiver by passage of a resolution as described in the act), the credit will appear as an additional line item on the monthly bill indicating the per kWh credit, the customer's monthly kWh deliveries and the total dollar value of the credit for the billing month.

Q. What will appear on the bills of customers in Providence and East Providence?

A. Assuming that the cities of Providence and East Providence exercise their option to waive the Customer Credit, the Company proposes to include a bill message on each customer's bill in each month that the Customer Credit would otherwise be in effect, indicating that the customer's credit has been applied to the undergrounding of the E-183 transmission line. The Company will work with the Commission and the Parties to determine the most appropriate wording of this bill message.

VIII. <u>CONCLUSION</u>

Q. Does this complete your testimony?

A. Yes, it does.