STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: NATIONAL GRID RHODE ISLAND – GAS REQUEST FOR CHANGE OF GAS DISTRIBUTION RATES PURSUANT TO R.I.G.L. §§ 39-3-10 AND 39-3-11	)))	**DOCKET NO. 3943**

MEMORANDUM OF LAW OF THE RHODE ISLAND ATTORNEY GENERAL

I. INTRODUCTION

The Rhode Island Public Utilities Commission ("Commission") requested the parties to prepare submissions regarding: (1) the Commission's authority to order the Gas Marketing Program ("Program") proposed by The Narragansett Electric Company, d/b/a National Grid (the "Company" or "NGrid") and (2) the Commission's authority to order the low income discount rate proposed by the Company. In addition, the Commission also requested the parties to submit post-hearing briefs[1] in the above-entitled matter. The Rhode Island Attorney General ("Attorney General") submits this memorandum of law pursuant to the Commission's requests in his capacity as advocate for the public.

[1] As set forth in the Attorney General's Opening Statement, with the exception of the low-income discount plan, the Attorney General generally supports and adopts the position that the Division has taken with respect to each of the principal issues that require resolution in this proceeding. At hearing, the Company agreed to exclude the low-income residential heating and non-heating classes from the proposed decoupling mechanism. Transcript dated 10/22/08 at 9, 90. The result affords the same treatment (for the purposes of decoupling) to these classes as that afforded to the large and extra large C&I classes. See Exhibit AG-1 (Page 1 of 2). Had decoupling been in effect in 2004 with the low income classes excluded from the decoupling mechanism, the revenues garnered from decoupling would have been reduced by roughly $500,000 per year. This is significantly less than the yearly amount which exclusion of the large and extra large C&I classes would have reduced decoupling revenues over a similar period of time. See Exhibit AG-1 (Page 1 of 2). If the Commission adopts some form of decoupling in Rhode Island, then the Commission should exclude the low-income residential heating and non-heating classes from the decoupling mechanism.

II. DISCUSSION

A. THE LEGALITY OF THE GAS MARKETING PROGRAM

1. Summary Of The Applicable Law

G.L. § 39-2-1.2(a) provides that "[i]n addition to costs prohibited in § 39-1-27.4(b), no public utility distributing or providing heat, electricity, or water to or for the public shall include as part of its base rate any expenses for advertising, either direct or indirect, which promotes the use of its product or service, or is designed to promote the public image of the industry." The General Assembly further has prohibited public utilities from furnishing "support of any kind, direct or indirect, to any subsidiary group, association, or individual for advertising and include the expense as part of its base rate," G.L. § 39-2-1.2(a); however, these prohibitions are not to be deemed as barring "the inclusion in the base rate of expenses incurred for advertising, informational or educational in nature, which is designed to promote public safety and conservation of the public utility's product or service." G.L. § 39-2-1.2(a).[2] G.L. § 39-2-1.2(a) also bars public utilities from furnishing "support of any kind, direct or indirect, to any subsidiary, group, association or individual for advertising and include the expense as part of its base rate."

The Rhode Island Supreme Court has had occasion to interpret § 39-2-1.2(a). In Valley Gas Co. v. Burke, 518 A.2d 1363, 1366 (R.I. 1986), Valley Gas Company ("Valley") contributed dues in the amount of $20,909 to an organization called the American Gas Association ("AGA"). Of the $20,909, $10,085 covered expenses

[2] In this statute, the General Assembly required the Commission to promulgate "such rules and regulations as are necessary to require public disclosure of all advertising expenses of any kind, direct or indirect, and to otherwise effectuate the provisions [of G.L. § 39-2-1.2(a)]." To the Attorney General's knowledge, no such rules have been promulgated to date.

associated with an "advertising program called the "American Gas Association Communications Program." Id. According to Valley, the Program was "informational and educational in nature," designed to "promote the efficient use of natural gas." Id. at 1366. More specifically, the AGA campaign was entitled "The Future Belongs to the Efficient" and consisted of "print advertisement extolling the efficiency with which certain gas furnaces, ranges, water heaters and other major home appliances operate . . . and further estimated the amount of money consumers would save by using these efficient products rather than standard, older models." Id. at 1367.

Before the Commission, Valley sought to recover $63,683 in total advertising expenses associated with the Program. Id. The Commission denied recovery of $53,648 of these expenses but allowed recovery of $10,035 of expenses associated with the Program. Id. On statutory petition for certiorari, the Rhode Island Supreme Court upheld the decision of the Commission. According to the Court,

> [a] review of the advertisements confirms they're informational, rather than promotional, in nature. The advertisements primarily encourage the use of certain, more efficient, gas appliances over other gas appliances and as such, encourages conservation *rather than merely promote the use of gas.*

Id. (emphasis added). This was "precisely the type of advertising that the exception within § 39-2-1.2(a) . . . was meant to encourage." Id. Thus, the Commission properly allowed recovery of $10,085 in informational advertising expenses and denied recovery of $53,648 in promotional advertising expenses, which did not fall within the exception. Id.

A number of authorities from other jurisdictions follow the holding of Valley Gas. These courts uphold public utility commissions when they have denied advertising expenditures that are aimed solely at achieving a rate increase. Ft. Smith v. Southwestern Bell Tel. Co., 247 S.W.2d 474, 483 (Ark. 1952), which promote an unregulated appliance business of the utility, Boston Consol. Gas Co. v. Department of Public Utilities, 97 N.E.2d 521, 526 (Mass. 1951), or that are promotional and excessive in magnitude. State v. Lone Star Gas Co., 86 S.W.2d 484, 504 (Tex. Ct. App. 1935), rev'd on other grounds, 304 U.S. 224, reh. den., 304 U.S. 590 (1938).

Disallowed expenses of this type, however, are not restricted to "advertising." The ultimate goal of statutory interpretation is to "give effect to the General Assembly's intent." Martone v. Johnston School Committee, 824 A.2d 426, 431 (R.I. 2003); Stebbins v. Wells, 818 A.2d 711, 715 (R.I. 2003). It is generally recognized that a public utility's distribution services "sell" themselves due to the fact that they are they considered "essential" services for which there exists little competition. See J. Bonbright, Principles of Public Utility Rates at 8 (1961). As a result, there is little need to expend ratepayer monies to promote sales of a public utility's distribution service or product over or to the detriment of customers' existing energy sources. Any such expenditure can create a rate that is unjust and unreasonable. El Paso Electric Co. v. New Mexico Public Service Comm'n, 706 P.2d 511, 514 (N.M. 1985).

Thus, a principal purpose of the prohibition of G.L. § 39-2-1.2(a) is to prevent the waste of ratepayer monies resulting from the unnecessary expenditure of such funds on promotional activities. Indeed, one court has upheld the decision of a public utilities commission when it denied as unlawful, "wasteful and unreasonable . . . allowances or payments to owners and developers who build all-electric homes and apartments and advertise them as such" and "contributions to dealer and distributor advertising of certain electric appliances." Application of Hawaiian Electric Co., 535 P.2d 1102, 1108-09 (Haw. 1975). Another court denied $440,000 in expenses that was spent to subsidize co-op adverting with dealers of gas appliances. East Ohio Gas Co. v. Public Utilities Comm'n of Ohio, 437 N.E.2d 594, 595 (Ohio 1982).

The New York Public Service Commission ("NYPSC") takes a similarly broad view of this general prohibition, barring the use of ratepayer monies to subsidize promotional activities of public utilities. In 1977, the NYPSC issued a ruling that reflected the culmination of a "notice of proposed policy statement" to re-examine the subject of advertising by public utilities that had been covered in a prior NYPSC policy statement in 1972. Statement at 1. With respect to natural gas, the NYPSC had concluded in the 1972 policy statement in pertinent part as follows:

> Effective January 1, 1972, all gas distributors . . . shall cease all promotional activities designed to acquire new gas customers or increase sales of gas to existing customers . . . Except to the extent indicated below, such prohibition shall apply to all advertising employing mass media, all bill inserts or other direct mailings to customers or others, and all calls by salesmen seeking to obtain or arrange "conversions" to gas space heating or to sell or promote the sale of gas appliances.

Statement at 6. The prohibition did not apply to: (a) "Service calls to repair existing gas equipment or recommendations relating to the replacement of such equipment…" (b) "Advice directed to existing customers as to how they may achieve the best heating and safety results with respect to existing gas equipment…" (c) "Direct contact with existing or potential customers for the purposes of encouraging the installation of dual-fuel equipment," and (d) "Individual responses to inquiries received by a gas company without prior solicitation." Statement at 6.

Upon reexamining the general bar against promotional activities by gas distribution companies and its limited exceptions in 1977, the NYPSC concluded:

> We have reexamined these requirements in light of current conditions and conclude that, for the most part they should remain unchanged . . . We are, however, concerned about the exception granted in item (c) above. Because additional demand for gas can be created as a result of direct contact with potential customers for the purpose of encouraging the installation of dual-fuel equipment we will no longer consider this a permissible activity by gas utilities.

Statement at 6-7.

In 2008, Con Edison contended that the "1977 policy statement" was "out-of-date," "an artifact of the past that has no valid application today." Proceeding on Motion of Commission as to Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Electric Service, Case 07-E-0523 at 43-44 (January 8, 2008). The NYPSC disagreed stating, "[t]he policy statement continues to have a valid purpose and it can be put to good use in today's circumstances." Id. at 47. Thus, under the Statement, the NYPSC confirmed that while "important information and public messages need not be curtailed," the Statement's limitations on promotional activities remain in effect. Id. See also DPUC Review of Service Policies, Docket No. 03-08-11 at 11 (requiring utilities to account for incremental promotional activities, including service contract advertising, separately and below the line).

Tariff Filing Made By The Providence Gas Company on February 16, 1995, Docket No. 2286, Order No. 14589 (November 17, 1995), which the Company cites in its pre-hearing memorandum of law, is not to the contrary. In fact, this Commission's decision in Order No. 14589 is entirely consistent with the aforementioned interpretation of G.L. § 39-2-1.2(a), associated precedent barring the expenditure of ratepayer monies on promotional activities, and the Statement of the NYPSC.

In Docket No. 2286, the Division had made a negative adjustment ($1,394,028) to the Company's proposed cost of service asserting that the entire adjustment was for "promotional, goodwill and institutional advertising expenses." Id. at 43. Of this adjustment, the Commission allowed $90,000 "agreed to by the Division" as "informational and conservation oriented advertising" and $847,000 in "labor expense." Id. at 44. The negative $847,000[3] adjustment consisted largely of what the Commission repeatedly characterized as *"normal informational"* labor expense associated with the sales of natural gas and consisted of the following: $498,063, "for "providing *information* and service to existing customers to service their energy needs; $66,846, for providing customers with "safety, *information and education* including *information* press releases, rate brochures, *etc.*; $60,889, for coordination of the trade allies program; $38,020, for market research; $30,913, contributions/community scholarships; $18,229, for federal and state program coordination (*i.e.*, low income energy assistance); $15,610, for research on new gas technologies; $8,506, for service support to gas transportation customers; $6,889, for promotions and direct mailing; and $1,975, for "administration of contractor rebates." Id. at 43-44 (emphasis added).

More significantly, in Order No. 14589, the Commission disallowed $457,000 in "promotional, goodwill and advertising expenses" of the original $1,394,028 Division adjustment. Id. at 44. The negative $457,000 adjustment constituted approximately 39% of the initial proposed $1,394,028 adjustment and spanned across accounts entitled:

[3] Of this amount, $101,491 of expenses was for positions eliminated during the Company's restructuring. Id. at 43.

"Supervision," "Promotional Advertising," "Sales Promotion," "Miscellaneous Expenses and "Goodwill and institutional advertising." Id.

Order No. 14589 not only conforms with the legal precedent and interpretation of § 39-2-1.2(a) discussed above but also is consistent with the testimony presented in this docket. Mr. Oliver testified as follows regarding the type of promotional marketing expenses that commissions typically have permitted public utilities to include in their base rates:

> Q. So are you saying that it's unusual for gas distribution companies to market conversions?
>
> A. When you say market, yes.
>
> Q. To seek—let's just say to try to get customers to switch from oil to gas use, to convert from oil to gas. That is an unusual activity for a gas distribution company?
>
> A. Over the last 15, 20 years it has been relatively unusual, yes.

Transcript dated 10/21/08 at 144.

As a general rule, then, expenses associated with the normal and usual sales of a utility's principal service (*i.e.,* "inescapable costs of doing business") are allowed. Statement of Policy on Advertising and Promotional Practices of Public Utilities at 12, (NYPSC February 25, 1977). Expenses that subsidize a utility's unregulated service, frustrate conservation efforts, or promote the utility's principal service to the detriment of or over another energy source are not recoverable from ratepayers. Id. at 4, 6. See also DPUC Review of the Service Policies and Contracts of the Local Distribution Companies, Docket No. 03-08-11, (Conn. June 9, 2004) (disallowing promotional expenses as an operating expense in rates).

2. Each of The Program's Components Promote Natural Gas Over Customers' Existing Energy Sources.

a. Customer Outreach and Education

The "Customer Outreach and Education" component of the Program consists of a concerted marketing effort to convince a target set of potential customers to convert to natural gas over their existing "energy choice." Exhibit NGrid-6 at 8, 9, 11. Through direct mailings, radio, and visual media, *etc.,* the Company represents to customers that they can "Save money" (because gas is more "efficient" than oil) and "Save space" (by "saying good-bye" to your old oil tank and the "soot, fumes and sulfur dioxide" of oil). See e.g. Exhibit AG-3 at 3, 12, 18, 20, 22. The Company also represents that customers can "find help" locating a "qualified" contractor through the Company's VPI Program and earn "valuable rebates . . . up to $1,500 on heating equipment," a $1,500 discount that'll make you're [the customer's] wallet happier too." See e.g., Exhibit AG-3 at 11, 12, 15, 16, 18. The stated purpose of these communications is to "identify potential conversion candidates" and to "pass those contacts on to local plumbing and heating contractors" participating in the Company's VPI program. Exhibit NGrid-6 at 15-16.

The Program's Customer Outreach and Education component is not tailored merely to inform customers about the benefits of natural gas in terms of efficiency and conservation. Rather, the component functions to identify, and then to steer target customers who do not have relationships with contractors towards contractors who will convert their system(s) to natural gas (*e.g.*, typically an "on-main conversion or low-use upgrade") from the customers' existing energy sources. Exhibit NGrid-6 at 16. The component, therefore, is purely promotional in nature. Valley Gas, 518 A.2d at 1367.

Substantially all of the testimony on the Record supports this conclusion. Mr. Mongan acknowledged that the direct mail materials that the Company forwarded to its customers in connection with the Program in late 2007 and early 2008 promote natural gas over oil in multiple ways: (i) by intimating that customers waste $.30 of every dollar in oil heat; (ii) by invoking fears that with oil comes the ever-present worry of a leaky tank; (iii) by implying that purchasing natural gas (rather than oil) is more patriotic because 97.3% of it as oppose to 56% for oil "comes from North America;" and (iv) by stating that burning oil inevitably produces "fumes" and "greenhouse gases" that are not associated with natural gas. Transcript dated 10/20/08 at 195-97.

Mr. Oliver,[4] a confirmed expert in the area marketing, cited many of these same instances, opining that the direct mail and media portions of the Program's Customer Outreach and Education component were promotional—not informational—in nature. See e.g., Transcript dated 10/23/08 at 163 ("natural gas will continue to cost less than fuel oil through 2008 . . . this trend will continue for the foreseeable future"); Transcript dated 10/23/08 at 165 ("...it [natural gas] produces no soot or fumes inside your home"); Transcript dated 10/23/08 at 165 ("...you'll never have to worry about a leaky oil tank buried in your yard or in your basement"); Transcript dated 10/23/08 at 171 ("56 percent of oil is imported"); Transcript dated 10/23/08 at 171 ("say goodbye to your oil tank. Clear out some extra space in your basement..."); Transcript dated 10/23/08 at 173 (materials contained in Exhibit AG-2 primarily advance natural gas over oil).

[4] Mr. Oliver was a member of the Board of Directors of the AOBA Alliance and also served as the chief economist of the group. In that capacity, he regularly had to evaluate various presentations and offerings to assess whether they were informational or promotional in nature. Transcript dated October 23, 2008 at 169.

Section 39-2-1.2(a) broadly bars the Company from recovering, or the Commission from ordering in a utility's base rate, expenses for activities that promote natural gas over customers' existing sources of energy. The proposed expenses associated with the Program are precisely the type of expenses that fall within the bar contained in § 39-2-1.2(a). Subject to the observation contained in footnote 13 of this memorandum, the Commission should deny all expenses associated with the Customer Outreach and Education component of the Program.

b. Installation Support And Associated Labor

The second component of the Program—"Installation Support" and associated labor ($150,000)[5]—runs afoul of § 39-2-1.2(a) for a similar reason. The VPI Program is a "contractor-referral system" that seeks "to facilitate the Company's efforts to increase system utilization in a cost-effective manner through low-use upgrades and on-main conversions," Exhibit NGrid-6 at 17, and specifically, is designed to "create a high level of customer satisfaction with the gas-conversion process." Exhibit NGrid-6 at 16. This "high level of customer satisfaction and convenience," facilitates the Company's effort to "increase system utilization." Exhibit NGrid-6 at 17. The principal aim of the VPI program and associated incremental labor, then, is to promote natural gas over customers' existing energy sources and to promote the public image of natural gas.

All of the other evidence on the Record supports this conclusion. Mr. Oliver testified that in his expert opinion the VPI program is promotional. Transcript dated

[5] "Direct costs" for a product or service are "those items that are easily traced to the product or service." Jerold L. Zimmerman, Accounting for Decision Making Control (5th ed. 2006). "Indirect expenses" are typically defined as expenses that are not charged to a particular unit of a good or to a particular service (*e.g.*, administrative overhead for human resources, accounts payable, rent, heat and lights) but nonetheless support the purpose for which the good or service is sold. County of Orange v. Barratt American, Inc., 58 Cal. Rptr. 3d 542-54 (Cal. Ct. App. 2007). The $150,000 of incremental labor constitutes an "indirect" expense under these definitions.

10/23/08 at 173. Mr. Mongan confirmed that the Company had engaged an "in bound inquiry rep" as well as an "inside sales rep" to handle all conversion related calls. Transcript dated 10/20/08 at 194. Customers that require contractors are steered to the VPI network. Transcript dated 10/20/08 at 194-95. Each rep, thus, serves the promotional aim of the Program: to facilitate customer conversions from other energy sources to natural gas.[6] Transcript dated 10/20/08 at 194-95. G.L. § 39-2-1.2(a) bars a utility from recovering expenses associated with these types of promotional activities or functions.

c. Equipment Discounts and Rebates

The Equipment Discount and Rebate components of the Program also serve to promote the use of gas over customers' existing sources of energy. Exhibit NGrid-6 at 18-19. Under the third component of the Program (Equipment Discounts), "purchased equipment is offered to customers . . . at a price that reflects both the Company's bulk-purchase discount and also at a further discount made available through the [Program] to enable customer conversions to gas service." Exhibit NGrid-6 at 18. "Because the cost of gas conversion can be higher than other fuel options available to the customer, the combination of the bulk purchasing discount and the program discount provide a valuable incentive to customers" to enable them to switch to gas service from their existing energy source. Exhibit NGrid-6 at 18 (emphasis added).

[6] Mr. Murphy, the customer of the Company who had problems with his gas burner, testified as to the typical way in which the VPI system serves to promote natural gas over oil: by enabling the contractor to "make the conversion sale" at the customer premises. Mr. Murphy testified that after receiving Company promotional materials in the mail and calling a designated telephone number, the Company referred him to a contractor. The contractor visited his house purportedly to size the new gas burner. Mr. Murphy then testified, "*They [the contractor] gave me an idea . . . of what it would cost and told me that it would be wonderful and how cheap it would be compared to oil, blah, blah blah. . . . He told me that oil was a problem, that it was expensive, that gas was so much cheaper on a comparison basis...*" Transcript dated 9/9/2008 at 193-94 (emphasis added).

The same is true for Equipment Rebates—the fourth component of the Program. "Customers who would prefer to purchase gas-heating equipment from a manufacturer that is not part of the Company's bulk purchasing program" are "eligible for a rebate of equal value to the program discount offered on equipment purchased by the Company from its manufacturing suppliers." Exhibit NGrid-6 at 18. This ensures that customers are able to obtain the same program incentive—the elimination of "incremental costs"—that "must be overcome in order to motivate new gas conversions." Exhibit NGrid-6 at 19 (emphasis added).

Most, if not all of the evidence on the Record, corroborates the promotional nature of Equipment Discounts and Rebates. Mr. Oliver testified that in his expert opinion, the Rebates and Discounts associated with the Program are promotional in nature:

> Q. Do you believe that those other components . . . the rebates and discounts that those have a characteristic that would advance one energy source over another?
>
> A. They tend to, yes.

Transcript dated 10/23/08 at 173. The Equipment Rebates and Discounts, moreover, are directly marketed to customers in the "Customer Outreach and Education" component of the Program. Transcript dated 10/20/08 at 197. Without the Rebates and Discounts, each of the other promotional components of the Program would not, and could not, function. Transcript dated 10/20/08 at 247-48.

G.L. § 39-2-1.2(a) bars a utility from recovering expenses associated with promotional activities in its base rate. Equipment Discounts/Rebates promote natural gas over customers' existing energy sources and serve to support the other promotional components of the Program. The Commission, therefore, should deny the Company's request to include expenses associated with the Discounts/Rebates in its proposed rates in the pending docket.

2. **The Company Has Not Presented Sufficient Evidence To Show That The Program Will Provide A Direct Ratepayer Benefit.**

G.L. § 39-2-1.2(a) bars the inclusion of direct or indirect expenses for promotional activities in the base rate of a public utility. The Company, nonetheless, contends that expenses associated with the Program may be included in a utility's base rate pursuant to jurisprudence adopted in some other jurisdictions (but not Rhode Island). This jurisprudence provides that when a utility's expenses can be characterized as "promotional" in nature, a presumption is created against ratepayer reimbursement of those expenses. Public Service Comm'n of the State of New York v. FERC, 813 F.2d 448, 456 (D.C. Cir. 1987). The utility, however, may rebut this presumption by showing that the putatively disallowed expenses directly benefit ratepayers. Id. See also Central Maine Power Co. v. Public Utilities Comm'n, 455 A.2d 34, 44 (Me. 1983); City of Canton v. Public Utilities Comm'n, 407 N.E.2d 9, 14 (Ohio 1980).[7]

Even if the Commission accepts this rebuttable presumption test (which it should not because the test is *not* the law in Rhode Island), the Company has not provided any quantitative analysis of the Internal Rate of Return ("IRR") for the Program *in the absence of the cost differential between heating oil and natural gas.* In other words, from the state of the Record, it is completely impossible to determine whether the asserted

[7] According to the Company, the "direct benefit" in the pending docket consists of "add[ed] sales revenues in excess of the Company's allowed rate of return, effectively reducing sales revenues that need to be recovered from other customers in order to meet the rate of return set by the Commission." Exhibit NGrid-6 at 24.

direct benefit is attributable to the Company's marketing efforts to date *or* to the price differential between natural gas and oil.

The Customer Outreach and Education component of the Program commenced in the last quarter of 2007. Exhibit AG-3 at 1.[8] For the first quarter of 2008, the Company completed 628 residential conversions—conversions, which the Company concedes "is a greater number of conversions than experienced in the past for the same period." Exhibit NGrid-7 at 9. The Company projects 1,950 incremental residential conversions in 2008, all the while conceding that during this time period natural gas has enjoyed and continues to enjoy a substantial price differential advantage as compared with oil—a differential which "is currently motivating some customers to commence the conversion process..." Exhibit NGrid-7 at 11. The Company concedes, moreover, that many (but not all of) the conversions to date can be attributed to the cost differential and not the Program. Exhibit NGrid-7 at 10.

At best, this testimony merely reflects that *some* of the "greater number of conversions" that the Company "experienced in the past for the same period" *may be* the result of the Company's recent marketing efforts. Nowhere has the Company shown that the uptick in conversions *has been* caused by the Company's marketing efforts, *to the exclusion of* the price differential between oil and natural gas. In fact the substantial evidence on the Record supports the conclusion that the uptick in conversions is the result of the current price differential between oil and natural gas.

[8] Mr. Mongan testified that the Company "commenced the education process with Rhode Island customers in May 2008." Exhibit NGrid-7 at 10. This statement is simply not accurate. See Exhibit AG-3 (showing that the Company forwarded multiple correspondences to Rhode Island ratepayers in the Fall of 2007).

Mr. Oliver testified as follows:

> Q. Do you have an opinion as to the cause of the increase in the number of conversions that's been experienced by the Company in 2008?
>
> A. ...With large differentials between oil and gas prices the economics, even without providing—without undertaking highly sophisticated analyses, very strongly suggest that not only today but in the long run heating with natural gas would be a preferred alternative.

Transcript dated 10/23/08 at 160-61. See also Exhibit DPUC-3 at 20 (where Mr. Oliver opines that it is the price differential between oil and natural gas which is driving the Company's current conversion success). Nor has the Company presented any evidence that the Program's projected IRR, *in the absence of the price differential effects*, exceeds the Company's allowed rate of return.

Without producing evidence to show a clear "causal connection" between the proposed expenditure of ratepayer funds and direct benefit, the Company has failed to rebut the presumption against ratepayer reimbursement for promotional marketing expenses. E.g., Public Service Comm'n of the State of New York, 813 F.2d at 456. Thus, even under the rebuttable presumption test espoused by the Company, the Commission should deny the Company's claim for ratepayer reimbursement of projected Program expenses ($1,377,000).

3. **The Substantial Evidence On The Record As A Whole Shows That The Program Will Produce Ratepayer Detriment.**

It is universally acknowledged as an established ratemaking principle that a regulated entity's revenues may not be used to pay expenses associated with a related affiliate's unregulated activity. G.L. § 39-2-1.2(a) ("public utility may not furnish support of any kind, direct or indirect, to any subsidiary, group association or individual for advertising and include that expense as part of its base rate"). See Boston Consolidated Gas, 97 N.E.2d at 526 (cost of appliance salesmen, of clerical work of the appliance business and cost of advertising appliances for sale were not proper charges to operating expenses of regulated gas entity). The prohibition against subsidization exists because it imposes an unfair burden on ratepayers and is flagrantly anticompetitive. The United States District Court for the District of Columbia has explained:

> As long as [a public utility] is engaged in both monopoly and competitive activities, it will have the incentive as well as the ability to 'milk' the rate-of-return regulated monopoly affiliated to subsidize its competitive ventures and thereby undersell its rivals in the markets where there is competition . . . To the extent that [the public utility] used the same facilities, equipment, and personnel to serve both its regulated and its unregulated activities, it would have the ability to over allocate the costs assigned to the former in order to maximize the amount that would be passed on to the ratepayers (who have no choice but to pay). Not only would this improper assignment of costs burden the ratepayers; it would also enable the company profitably to charge less for its competitive products and services who enjoy no such subsidy.

United States v. Western Elec. Co., Inc., 592 F. Supp. 846, 853 (D. D.C. 1984); PPL Electric Utilities Corp v. Pennsylvania Public Utility Comm'n, 912 A.2d 386, 409 (Pa. 2006). See also In Re: Tariff Filing Made by the South County Gas Company on September 17, 1982, Docket No. 1671, Order No. 10950 at 28 (June 17, 1983) (advertising expense for pictures of stoves, space heaters, *etc.* was promotional and, therefore, disallowed); Exhibit DPUC-3 at 28 ("...[the Company's] plans to arrange the purchase and resale of natural gas heating equipment at below market prices may have anti-competitive implications").

The Company has failed to show that requiring ratepayers to pay for the Program will produce a direct ratepayer benefit. Rather most, if not all of the evidence on the

Record, shows that ratepayers will be harmed if they are required to "reimburse" the Company for Program expenses.

The Company concedes that it owns an unregulated affiliate, National Grid Energy Services, which provides the same type of conversion services, as those afforded to existing and potential customers under the Program. Transcript dated 10/20/08 at 132-33. The Company contends that its affiliate participates "on an equal playing field with other plumbing and heating contractors without any anti-competitive effect or favorable treatment because the system is well structured to fairly and evenly distribute leads." Exhibit NGrid-7 at 23.

The Company's averment in this respect does not rebut the evident fact that were ratepayers required to pay for all of the expenses associated with the Program, they would be subsidizing the Company's unregulated affiliate's own marketing activities. That is, ratepayers would pay for the *entire* cost of "identifying conversion opportunities" (Customer Outreach and Education)[9] for both VPI contractors and the affiliate alike.

Even worse, contrary to the Company's representation that conversion opportunities are evenly distributed between the affiliate and other VPI contractors, Mr. Mongan testified that the opportunities are distributed to the affiliate based on *"other criteria built into the rotation..."* Transcript dated 10/20/2008 at 199 (emphasis added). Thus, not only do ratepayers pay for the affiliate's cost of conversion opportunity identification, but also they do so with the very real risk that the affiliate will receive conversion opportunities on a preferential basis.

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[9] Identified by the Company as $181,155 through the spring of 2008. Exhibit PUC-1 (Response to Commission Data Request 1-6).

If approved by this Commission, the Program would harm ratepayers in two additional ways. First, the unregulated affiliate would receive *gratis* the benefit of the inbound inquiry rep's and inside sales rep's activities. Conversion opportunities that are forwarded to VPI contractors via the inbound inquiry and inside sales reps would be paid for *entirely* with ratepayer monies. Transcript dated 10/20/2008 at 199. No evidence exists on the Record to show that the unregulated affiliate would bear its proportional cost of the inbound inquiry rep and/or inside sales rep.

Secondly, ratepayers (via the Program) would pay for the Equipment Discounts and Rebates afforded to VPI contractors' and the unregulated affiliate's customers, alike. Transcript dated 10/20/2008 at 200. No evidence exists on the Record to show that the unregulated affiliate would contribute in any manner to these funds or bear its fair share of these expenses. In fact, just the opposite is true. The entirety of the evidence shows that the unregulated affiliate would be able to offer its customers use of Equipment Rebates and Discounts—ratepayer monies—like every other VPI installer. Transcript dated 10/22/2008 at 161; Transcript dated 10/20/2008 at 200.

Without substantial evidence on the Record to rebut the *prima facie* unduly burdensome and anticompetitive nature of the Program, the Commission is required to deny the Company's claim to include expenses of the Program in the utility's base rate. G.L. § 39-2-1.2(a) (expressly barring public utilities from furnishing support to any utility subsidiary for advertising and including the expense as part of its base rate). See also In Re: Tariff Filing Made by Providence Gas Company on January 15, 1993, Docket No. 2082, Order No. 14311 (October 14, 1993) at 21 (non-utility operations must be separate and apart from regulated utility functions and it was appropriate absent separation to reduce cost of service by $260,242 and revenues by $185,000).

B. THE COMMISSION POSSESSES THE AUTHORITY TO APPROVE THE COMPANY'S LOW INCOME DISCOUNT PLAN.

The General Assembly has expressly vested public utilities, upon the approval of the "division," with the authority to approve free utility service "upon such conditions as the public utility may impose." G.L. § 39-2-5(2). The same section further provides that public utilities may grant "special rates to any special class or classes of persons" so long as the rates are "just and reasonable" or "in the interest of the public" and are not "unjustly discriminatory." Id.

As will be seen at footnote 10 infra, § 39-2-5(2) applies to the Commission as well as the "division." Moreover, the Rhode Island Supreme Court has recognized that while the Commission is not authorized by Title 39, Chapter 2, 3 or 5 to mandate a utility provide preferential rates at either the expense of its shareholders or other customers, Blackstone Valley Chamber of Commerce v. Public Utilities Comm'n, 396 A.2d 102, 105 (R.I. 1979), an exemption for the first 300 KWH used by residential customers (whether, elderly, disadvantaged or affluent) can be sustained to "eliminate or palliate past discrimination or to improve allocation of cost of service [and] would be among the appropriate objectives toward which the commission may exercise its power in approving rate design." Id. The Supreme Court re-affirmed this fundamental principle of public utility law—that the Commission is authorized to approve discounted rates under appropriate circumstances—in Violet v. Narragansett Electric Co., 505 A.2d 1149 (R.I. 1986).

In Violet, the Court upheld Commission approval of a 20% discount plan for industrial and large commercial ratepayers under certain conditions, as "just and reasonable and in the public interest." Id. at 1152. The Court then turned to the question as to whether the plan complied with the dictates of § 39-2-5(b), which, as set forth above, provides that "the division"[10] may approve discounts if the rates in question are "just and reasonable" or in the "public interest."[11] The Court responded in the affirmative. According to the Court, the proposed discount plan produced a "just and reasonable" end result and was in the "public interest" because, "in the Commission's eyes," it might give substance to "'one of the more pressing needs of this state, that is, the creation of new jobs.'" Id.

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[10] In 1912, the General Assembly vested the same authority *verbatim* (*i.e.*, the authority to approve "just," "reasonable," and not "unduly discriminatory" public utility rates. . . to any special class or classes of persons") in the pre-1935 public utilities commission. P.L. 1912 ch. 795 § 42. The Division assumed these duties when the agency was created in 1935 and the commission was abolished. P.L. 1935, Ch. 2250 § 72. A post World War II "public utilities commission" dates back to 1969 when the agency was recreated within, but "independent of," the Department of Business Regulation, along side of the Division. Functional separation between the Division and commission commenced in 1973 when the commission assumed jurisdiction over "hearings involving rates, tariffs, tolls and charges..." within the Department of Business Regulation. P.L. 1973, Ch. 199.

The General Assembly created the modern day Commission in 1980, vesting the Commission with the authority to "carry out, except as otherwise provided by this title [Title 42], the provisions of chapters 1 – 20, inclusive of title 39, and all other general laws and public laws heretofore carried out by the former administrator of public utilities and carriers and division of public utilities and carriers." G.L. § 42-14.3-1 (emphasis added). Accordingly, to the extent that the department's commission had not already assumed such powers in 1973, the General Assembly made it clear in 1980 that the Commission was vested with all of the powers of the Administrator and Division. These powers included the authority over "just, reasonable and not unduly discriminatory rates to any special class or classes of persons..." (*i.e.,* G.L. § 39-2-5(b) authority that the pre-1935 commission had possessed in 1912).

In light of this history, it is no surprise that the Violet Court applied § 39-2-5(b) to uphold Commission (not Division) authority to uphold a proposed discount plan. Violet, 505 A.2d at 1152. The Company is entirely correct when it observes that G.L. § 39-2-5(b) provides the Commission with ample authority to approve discount plans. Company Memorandum Regarding Legal Basis of Low Income Discount Rate at 3-4.

[11] The Court had already observed that The Narragansett Electric Company had presented credible evidence to support its contention that the plan was cost justified (and therefore also not "unjustly discriminatory" under § 49-2-5(b)). Violet, 505 A.2d at 1151-52.

The Supreme Court has re-affirmed Violet, admonishing litigants not to construe the holding of that case too narrowly. In Energy Council of Rhode Island v. Public Utilities Comm'n, 773 A.2d 853, 861 (R.I. 2001), TEC-RI contended that Violet permitted "discriminatory rates *only when* a cost differential exists in providing services to different classes of consumers" (emphasis added). The Court flatly rejected TEC-RI's argument. The Court reiterated its long-standing jurisprudence that a "cost differential" is not "the only justification for rate disparities." Id. at n. 9. See also United States v. Public Utilities Comm'n, 393 A.2d at 1097 (commission may consider other factors such as "value of service to the community, historical rate design, adequacy of service, environmental consideration, public benefit and the like, that may warrant a departure from or modification of the rates dictated by cost-of-service"); Town of Narragansett v. Malachowski, 621 A.2d 190, 196 (the same). To interpret Violet and "the anti-discrimination statutory provision in the way TEC-RI asserts is both misguided and appears to constitute a spurious application of logic." Energy Council, 773 A.2d at 861, n. 9.

Blackstone Valley, Violet, and Energy Council then reflect the Court's consistent affirmation of the following legal principles: (i) the General Assembly has authorized the Commission to approve preferential rates through "rate design;" (ii) the approved rates must be just and reasonable or in the public interest; and (iii) the approved rates may not be "unjustly discriminatory," as determined by cost of service or other relevant factors such as historical rate design, adequacy of service, environmental consideration, public benefit, *etc.* Based upon the aforementioned legal analysis, as well as the testimony in this docket, the Attorney General believes that the Commission not only possesses legal authority to approve the Company's 10% Low Income Discount Plan (the "Plan"), but also that the Plan is just and reasonable, in the public interest and not unjustly discriminatory.

The Plan will provide low-income customers with some additional financial assistance ($829,338) in addition to the Company's existing $1,785,000 low-income assistance funding. Exhibit NGrid-14 (NG-DAH-4). The Record reflects that these customers live at the margin, and are having a particularly difficult time paying their bills in the face of substantial increases in energy prices over the past year. Mr. Czekanski testified as follows:

> ...There are numerous . . . There's clear evidence that there are people who are struggling, energy costs, all costs of living have gone up significantly . . . These are some tough economic times.

Transcript dated 9/11/08 at 171. Providing additional assistance to these customers through the Plan will also ameliorate what is considered a pressing "need of the State:" to ensure the State's financially disadvantaged are not deprived from receiving an essential utility service. Violet, 505 A.2d at 1152.

In addition, implementation of a low-income discount rate will benefit other ratepayers by reducing the overall revenue requirement by $150,000. See Transcript dated 9/11/08 at 171 (reflecting the stipulation between the Company and the Division concerning the reduction in the Company's uncollectables). The entirety of the evidence on the Record supports this public interest benefit. Again, Mr. Czekanski testified:

> Q. Isn't that a benefit of reducing the Company's overall revenue requirement by $150,000 of the low income discount being implemented that there's a reduction in uncollectables?

A. Yes...

Q. ...How does that help other customers?

A. ...it reduces the revenue requirement, so when we're establishing rates, rates will now be—$150,000 less than they otherwise would have.

Transcript dated 9/11/08 at 176-77.

The substantial evidence on the Record also reflects that the Company's Plan is not unjustly discriminatory. In response to the question as to how the Company went about designing the rates in the face of the current "economic downturn," Mr. Heintz, the Company's rate design expert, testified as follows:

> The things we have to look at . . . is how much of that increase should be the responsibility of the industrial classes or the commercial/industrial classes versus the residential classes given the credit problems, the economic situation we all see . . . it's a balancing of that plus . . . what are the classes currently contributing towards the company's revenue requirement, how far above or below the system average return they are and try to weight that . . . And in this case what we did is that the residential classes were very close to the system average return, so they only got the average —we only allocated to them the average return, average increase rather than anything greater, and then there were some classes that were above the system average return, some below, and we tried to —tried to equalize that to try to move them closer to the system average.

Transcript dated 10/20/08 at 96-97. Mr. Czekanski confirmed that the Company had designed its rates, and allocated the low-income discount in particular, in a fair and equitable manner among the Company's rate classes:

Q. ...how [is] the ten percent discount . . . in the best interest of the ratepayers?

A. Our judgment was to balance the need of all customers. We looked . . . the problems of the low income and trying to come up with some way of assistance that would not in our opinion unfairly burden the other customers who are not in the low income classification . . . at a ten percent discount it would have a

> cost of about $800,000 . . . Looking at what the impact would be on the different classes . . . we felt that that would not unduly burden them and therefore that was our proposal.

Transcript dated 10/20/08 at 228-29. In the end, the "judgment call" made by the Company in terms of rate design appropriately balances the interests of each of the Company's classes of customers (along with the interests of the Company) so that no one class bears an "undue" proportion of the proposed increase resulting from the Plan. Transcript dated 10/20/08 at 107.[12]

The expenses associated with the Plan are just and reasonable, in the public interest and not unjustly discriminatory. Therefore, the Commission should allow these

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[12] On October 8, 2008, the Commission's counsel expressed a concern (off the Record) that the first clause of § 39-2-5(13) could be construed to repeal § 39-2-5(2) even though the General Assembly has not repealed § 39-2-5(2) and did repeal § 42-141-5(d) referenced in § 39-2-5(13). Rhode Island follows the generally accepted rules of statutory construction that "implied repeal[s] of preceding statutory enactments" are not favored by the law. Thompson v. DeNardo, 448 A.2d 739, 740 (R.I. 1982). Thus, "when the repealing effect of a statute is doubtful, the statute must be construed to effectuate consistent operation with previous legislation." Berthiaume v. School Committee of the City of Woonsocket, 397 A.2d 889, 893 (R.I. 1979). These rules are "especially strong" when Congress has expressly repealed a provision of the intervening statute (which purportedly has repealed the prior statute), and fails to repeal the prior statute. Hagen v. Utah, 510 U.S. 399, 416 (1994). The logic against a repeal in such circumstances is that if the Legislature had intended to repeal the prior statute, "it could easily have done so" at the time of the express repeal. Id. Partial implied repeals can only occur upon a finding of repugnancy, *i.e.,* when the subject matter of the subsequent legislation "usurps the whole ground" of the first legislation. State of Rhode Island v. Narragansett Indian Tribe, 19 F.3d 685, 704 (1st Cir. 1994).

Commission counsel's concern is easily allayed by an application of these principles to the pending docket. The alleged repealing effect of the first clause of § 39-2-5(13) is highly doubtful. Nowhere did the General Assembly manifest an intent by that clause's enactment to repeal § 39-2-5(2) for numerous reasons: (i) nowhere does § 39-2-5(13) state "§ 39-2-5(2) is repealed" or words to that effect, (ii) § 39-2-5(13) does not state that it provides the *exclusive* authority for a gas or electric distribution company to provide discounts to low-income customers, and therefore, § 39-2-5(13) is not repugnant to § 39-2-5(2); (iii) § 39-2-5(13) does not wholly subsume § 39-2-5(2); (iv) The General Assembly repealed a portion of § 39-2-5(13), thereby manifesting an intent to render that entire provision a nullity; and (v) Had the General Assembly intended otherwise "it could easily have" expressly repealed § 39-2-5(2) when it repealed § 42-141-5(d) and the reference to that section in § 39-2-5(13). Hagen, 510 U.S. at 416.

Based on these factors, the Commission is required to construe § 39-2-5(13) in a manner that is consistent with the operation § 39-2-5(2). By enacting § 39-2-5(13) (and Title 42, Chapter 141), the General Assembly intended to provide an additional path by which economically disadvantaged persons might obtain rate relief in gas and electric rate cases. The General Assembly did not intend § 39-2-5(13) to repeal the Commission's general authority to provide free utility service or special rates to any particular class of ratepayers pursuant to § 39-2-5(2). No basis, then, exists for the concern that § 39-2-5(13) acts (impliedly or otherwise) as a repeal of § 39-2-5(2).

expenses in the Company's base rate as proposed by the Company in its pending rate application.

III. CONCLUSION

G.L. § 39-2-1.2(a) prohibits a gas utility from including, and the Commission from approving, expenses for advertising in the utility's base rate. Advertising includes all forms of media, as well as all activities (incremental labor, discounts, rebates, *etc.*) that serve to promote customers' conversions to natural gas from their existing energy sources. Each of the Program's components fall within either of these two categories.

Even if the Commission construes G.L. § 39-2-1.2(a) to permit the inclusion of expenses for promotional activities in a utility's base rate when the utility can show that the expenses have a direct benefit to ratepayers, the Company has failed to sustain its burden of proof in this regard. The Company has failed to establish a causal connection between the Program (and its associated expenses) and its alleged benefits to ratepayers.

Moreover, the Company has failed to rebut the Program's evident unduly burdensome and anticompetitive effects upon ratepayers. The Company's unregulated affiliate, National Grid Energy Services, receives leads generated by the Program, is the beneficiary of incremental labor requested by the Company, and has access to Rebates and Discount moneys awarded to customers under the Program. No evidence exists on the Record to show that the National Grid Energy Services bears any of, or its fair share of, the expenses of the Program. For all of the foregoing reasons, the Commission should deny the inclusion in the Company's base rate of all expenses associated with the Program.[13]

Pursuant to G.L. § 39-2-5(2), the Commission possesses express statutory authority to grant free utility service upon such conditions as the public utility may impose, and may grant "special rates to any special class or classes of persons" so long as the rates are "just and reasonable" or "in the interest of the public" and are not "unjustly discriminatory."

The expenses associated with the Plan are just and reasonable; the Plan is not unjustly discriminatory; and the Plan is in the public interest. Accordingly, the Commission should allow all expenses associated with the Plan as proposed by the Company.

Respectfully submitted,

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[13] The Division has recommended that the Commission allow $148,000 of expenses associated with the Program—an amount equal to the planned spending of Rhode Island oil dealers. Exhibit DPUC-3 at 27. The Attorney General does not oppose the Division's recommendation in this regard so long as the direct mail, media, *etc.* (upon which the monies presumably will be expended) do not contain language (as they currently do) promoting natural gas *over other energy sources* but are truly informational and educational in nature.

CERTIFICATE OF SERVICE

I certify that a copy of the within memorandum of law was served by e-mail to all persons listed this date on the service list for PUC Docket Nos. 3943 on the 6^{th} day of November, 2008.