

April 1, 2008

VIA HAND DELIVERY & ELECTRONIC MAIL

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

**RE: National Grid Application for Rate Change
Pursuant to R.I.G.L. §§ 39-3-10 and 39-3-11**

Dear Ms. Massaro:

Enclosed for filing is an original and nine (9) copies of the application by National Grid¹ for a change in gas distribution rates pursuant to R.I.G.L. § 39-3-10 and § 39-3-11.

As described in the filing, the Company is seeking an increase in its gas distribution rates to recover the costs it needs to operate a safe and reliable gas distribution system. The amount of the increase is \$20.04 million, representing an increase of 4.6 percent on total gas revenues. If approved, this would be the first gas distribution increase in ten years.

In accordance with Commission Rule 2.5(a) and (b), the Company's complete direct case is hereby submitted in the form of prepared written testimony and attachments, along with the Company's current and proposed tariffs. Also, in accordance with Commission Rule 2.5(e), the Company has included all supporting information and records required under Rule 2.4 through 2.10. Lastly, pursuant to Rule 2.6(a), the Company has based its revenue-deficiency analysis on a test year ending September 30, 2007.

Main Reasons for the Rate Increase

The request for an increase is being driven largely by the need to step up the replacement of aging mains and services on the gas distribution system, which are the source of an increasing number of gas leaks and emissions in Rhode Island. As stated in the testimony, replacing this aging infrastructure and reducing the number of leaks is in the public interest because it will greatly improve safety and reliability, will reduce gas losses, and will mitigate the release of carbon emissions that are harmful to the environment.

In addition to the need to address infrastructure investment, the Company is experiencing the impact of two other factors outside of its control. First, the cost of operating and maintaining the distribution system has risen dramatically since the Company's last base-rate increase over 10 years ago due to inflation in the price of goods and services needed to serve Rhode Island gas

¹ Submitted on behalf of The Narragansett Electric Company d/b/a National Grid.

customers. Second, customer conservation efforts driven by more efficient technologies supported by the Company, as well as substantially higher gas commodity prices over which the Company has no control have substantially deteriorated the revenues generated through the Company's existing base rates. For example, the Company has experienced annualized lost revenues totaling \$7.64 million since June 2004 for the residential heating class alone. Unfortunately, in light of ongoing capital requirements, increasing O&M costs and declining revenues per customer, the Company has exhausted available opportunities to avoid an increase in rates. The Company seeks to continue to promote these conservation efforts while at the same time maintaining a safe, reliable, and sound delivery system.

Other Proposals Contained in the Filing

In this filing, the Company also has set forth a series of proposals that, on a collective basis, are designed to deal directly with the factors that currently make it difficult to maintain an adequate level of cost recovery and rate stability over time. If approved by the Commission, these proposals would restore the Company's ability to fund utility operations on a going forward basis without the need for repeated rate cases, and in doing so, would serve the interests of Rhode Island customers in having access to safe and reliable gas service, at the lowest reasonable cost over the long term. The specific proposals made in the Company's filing include the following:

- **Revenue Decoupling – Aligning Rates to Encourage Greater Energy Efficiency**

As stated in the testimony in this filing, the Commission and governmental leaders in Rhode Island have recognized the need to implement broad-based energy efficiency and conservation programs, which will be offered to customers through National Grid. National Grid is a strong supporter of energy efficiency and conservation efforts because initiatives to reduce energy consumption are good for customers (in terms of reducing their energy cost) and for the environment. However, as the Company moves aggressively to advance the public policy objectives of increased efficiency, it is at the same time working to reduce its sales revenues because those revenues are currently dependent on the volume of gas delivered to customers. In an environment where energy conservation is paramount, this places the Company in the precarious position where its efforts to advance the policy objectives of Rhode Island policymakers produce a negative effect for the Company in terms of its recovery of the revenues necessary to run operations on a safe and reliable basis. In its filing, the Company is proposing a revenue-decoupling mechanism, which is designed to facilitate the expansion of gas efficiency programs by removing the Company's dependency on customer gas usage to generate the revenues necessary for safe and reliable operation of the system.

- **Encouraging Cost-Effective System Utilization**

Under public-utility ratemaking principles, cost-effective system utilization is beneficial to the Company and its firm customers because it allows the fixed costs of building, maintaining and operating the Rhode Island distribution system to be spread over a larger customer base. In addition, encouraging the expansion of natural gas service is consistent with national energy

policy, which favors the use of natural gas as the environmentally sound alternative to other forms of energy. Moreover, efforts to increase system utilization are especially important where there is a strong movement to encourage end-use conservation because the fixed costs of the system will have to be recovered over diminishing units, unless new customers are added to share in those costs (and in the Company's conservation efforts). In this filing, the Company is proposing the establishment of a Gas Marketing Program that would encourage and facilitate conversions of new and existing low-use customers to gas service in order to maintain an adequate customer base and to help to reduce costs for existing customers.

- **Accelerated Capital Investment for Safety and Reliability**

National Grid now has had over a year of experience to evaluate the condition of the gas distribution system in Rhode Island. From that review and experience, National Grid has concluded that the pace of certain capital replacement programs needs to be accelerated to achieve a greater level of safety and reliability. The number of leaks experienced by the Company in a year is a direct function of pipeline integrity. The accelerated replacement of bare steel and cast-iron mains will significantly reduce the number of leaks occurring on a year-to-year basis, which in addition to the obvious safety and reliability benefit, would produce environmental benefits. In this filing, the Company is proposing to establish a discrete funding mechanism to support the accelerated replacement of bare-steel and cast-iron mains as well as high-pressure, bare-steel services located inside customer premises.

- **Treatment of Merger-Related Synergies**

In August 2006, National Grid acquired the Rhode Island gas distribution assets of Southern Union Company, which owned and operated the former New England Gas Company. In August 2007, National Grid completed its merger with KeySpan Corporation, which owned and operated natural gas distribution companies in New York, Massachusetts and New Hampshire. In this filing, the Company has quantified annual net savings resulting from the National Grid/Southern Union asset purchase and the National Grid/KeySpan merger and has reduced the cost of service with the customer portion of the resulting synergy savings. Specifically, the Company has reduced the cost of service by approximately \$3.6 million annually to account for the customer-share of realized and planned synergy savings.

- **Low-Income Distribution Rates for Eligible Residential Customers**

National Grid has a strong commitment to its customers and recognizes that the changes proposed in this filing are coming at a difficult time given the economic environment. Therefore, in this filing, the Company is proposing to establish a discounted distribution rate for the residential heating and non-heating classes. The proposed low-income rates would provide a 10 percent discount off of the distribution component rates ultimately approved by the Commission in this proceeding. Eligibility for the Company's low-income rate would be based upon verification of a customer's eligibility for LIHEAP or its successor program. National Grid anticipates that approximately 16,000 customers will benefit from the Low Income Residential Heating Rates

based on the average number of residential gas customers that received LIHEAP grants over the past two years and that approximately 2,500 customers will benefit from the Low Income Non-Heating Rates

- **Alternative Proposal to Establish a Three-Year Rate Plan**

Given the magnitude of the revenue deficiency existing at this point in time, the Company also includes in this filing an alternative rate plan that, if adopted, would phase in a three-year revenue requirement, which would mitigate the initial-year rate adjustment by approximately 31 percent and establish a levelized revenue-requirement increase over a three-year period.

Bill Impact on Typical Residential Heating Customer

If approved by the Commission, the Company's request for base-rate relief would have varying impacts for individual customers. Generally, the annual bill impact for a typical residential heating customer using 922 therms per year would be 5.1 percent or \$72 per year on average. Commercial and industrial customers would experience annual bill impacts ranging from an increase of one to four percent over the course of a year.

Thank you for your attention to this transmittal. If you have any questions, please call me at (401) 784-7667.

Very truly yours,



Thomas R. Teehan

Enclosures

cc:

Paul Roberti, Esq., Office of the Attorney General
Steve Scialabba, RI Division of Public Utilities and Carriers