

PRE-FILED DIRECT TESTIMONY

OF

SEAN P. MONGAN

Table of Contents

I. Introduction..... 1

II. Purpose Of The Gas-Marketing Program..... 4

III. Program Components..... 13

IV. Program Economics..... 21

V. Conclusion 27

1 **I. INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.**

3 A. My name is Sean P. Mongan. My business address is One Metrotech Center,
4 Brooklyn, NY. I am Director of Operations and Process Support for the Energy
5 Solutions Service Group for National Grid USA (“National Grid”).

6 **Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?**

7 A. I graduated from the University of Rochester in 1983 with a Bachelor of Science
8 degree in Engineering. In the period 1983 through 1985, I worked for a small
9 construction firm and as Safety Engineer for Liberty Mutual Insurance. In 1985, I
10 joined the Long Island Lighting Company (“LILCo”) as an engineer in the customer
11 services group handling independent power management. For the period 1987
12 through 1990, I performed project management for gas and electric capital work
13 completed by LILCo to serve customers. In 1990, I accepted a special assignment to
14 develop and implement the structural organization to support a comprehensive system-
15 growth business plan and assumed management responsibilities following its
16 implementation, acting as Manager of Sales Operations through the merger with
17 Brooklyn Union Gas Company in 1998. Following the merger of LILCo and
18 Brooklyn Union, I became Director of Inside Sales and Marketing Operations, with
19 responsibility for coordinating and overseeing the Company’s growth plan through the
20 efforts of the sales, construction and operations groups. In 2002, I became the

1 Director of Sales for KeySpan Energy Delivery Long Island (“KEDLI”), and in 2006,
2 I became the Director of Business Markets, Sales and Account Management for
3 KEDLI and KeySpan Energy Delivery New England. I assumed my current position
4 as Director of Operations and Process Support for the Energy Solutions Service Group
5 in 2007.

6 **Q. WOULD YOU BRIEFLY DESCRIBE YOUR CURRENT AREAS OF**
7 **RESPONSIBILITY FOR NATIONAL GRID?**

8 A. Yes. In my position as Director of Operations and Process Support, I have
9 responsibility for planning, supervising and evaluating the marketing and sales
10 initiatives conducted for the National Grid’s gas-distribution companies, including the
11 former operations of KeySpan Energy Delivery in New York, Massachusetts and New
12 Hampshire. My overall responsibility is to create cost-effective programs and
13 initiatives to expand the Company’s customer base so that the net revenues brought to
14 the system by these added customers will help to reduce the rates resulting from the
15 Company’s overall cost of service over time. To achieve this objective, the Company
16 has established a comprehensive organization and program structure aimed at
17 motivating conversions to gas service by “low-use customers,” who are residential and
18 commercial and industrial (“C&I”) non-heating customers currently served by the
19 Company (and therefore already connected to the distribution system), and by new
20 customers who may be facing a fuel-choice decision. The Company motivates

1 conversions and new customer additions through customer education and outreach
2 activities, business and field sales, developing and maintaining trade ally and account
3 relationships with heating and plumbing contractors, supporting economic
4 development and assisting in technical sales and project-management for customers. I
5 am responsible for overseeing all of these aspects of the Company's program
6 framework and ensuring that the Company's strong commitment to beneficial system
7 growth is realized.

8 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

9 A. My testimony presents the Company's proposal to initiate a Gas Marketing Program
10 in Rhode Island to encourage migration to natural gas service from other fuel sources
11 so that the fixed costs of the distribution system would be spread across a larger
12 customer base over time. To support this program, the Company is proposing to
13 include certain program costs in distribution rates based on a showing that the net
14 impact to customers will be positive in terms of increasing throughput and reducing
15 rates below the level that would otherwise result from the Company's cost of service.
16 To that end, my testimony is organized as follows: Section II provides an overview of
17 the Company's philosophy and approach for expanding gas service in Rhode Island
18 through the Gas Marketing Program; discusses the economic and market factors
19 driving the Company's proposal, and discusses how the proposal furthers the
20 important environmental policy objectives enunciated by Rhode Island policymakers.

1 Section III outlines the Company's proposed Gas Marketing Program and provides
2 details on the program's methodologies and objectives. Section IV presents a
3 quantitative demonstration of the cost-effectiveness of the Company's program and
4 the net benefits that would be realized by customers were the Commission to approve
5 the Company's proposal. Section V is my conclusion.

6 **II. PURPOSE OF THE GAS-MARKETING PROGRAM**

7 **Q. WHAT IS THE BASIC OBJECTIVE OF THE COMPANY'S GAS-**
8 **MARKETING PROGRAM?**

9 A. The basic objective of the Company's Gas-Marketing Program is to encourage cost-
10 effective, increased system utilization through conversions of new and existing low-
11 use customers to gas service. Under public-utility ratemaking principles, increased
12 system utilization brings benefits to the Company and its firm customers because it
13 allows the fixed costs of building, maintaining and operating the Rhode Island
14 distribution system to be spread over a larger customer base (and associated billing
15 units). In addition, encouraging greater system utilization is consistent with national
16 energy policy, which favors the use of natural gas as the environmentally sound
17 alternative to other forms of energy. Moreover, although it may be counterintuitive,
18 efforts to increase system utilization are especially important where there is a strong
19 movement to encourage end-use conservation because the fixed costs of the system

1 will have to be recovered over ever-diminishing units, unless new customers are added
2 to share in those costs (as well as the Company's conservation efforts).

3 For all of these reasons, the Company views the implementation of the Gas Marketing
4 Program as a critical and long overdue initiative for Rhode Island. Based on the
5 Company's actual experience in other jurisdictions in which the program is offered,
6 the Gas Marketing Program is a proven "win/win" strategy for maximizing system
7 utilization for the benefit of customers and serving environmental policy goals in a
8 market where there is also an emphasis on the need to contain the overall cost of
9 service to customers.

10 **Q. WHAT IS MEANT BY "COST-EFFECTIVE" SYSTEM UTILIZATION?**

11 A. The key underpinning of the Gas Marketing Program is that it is designed to add
12 customers on a cost-effective basis from a system perspective. This means that the
13 cost of adding the customer is less than the revenue stream that is produced by the
14 customer over a reasonable service period. Since, in a ratemaking proceeding, base
15 rates are set by allocating cost recovery over the available "billing units," successful
16 efforts to add customer load on a cost-effective basis has the direct result of lowering
17 the distribution price below what the rate would otherwise be, all else being equal. In
18 Section IV below, the Company describes its economic analysis, which is used to
19 determine whether customer additions will be cost effective for the system, and

1 explains how the benefits available through program implementation are factored into
2 the revenue requirement in this case.

3 **Q. WHAT ARE THE FACTORS THAT NECESSITATE A PROACTIVE**
4 **APPROACH TO BUILDING SYSTEM UTILIZATION IN THE NATURAL**
5 **GAS INDUSTRY?**

6 A. Although not “competitive” from a distribution perspective, the sale of natural gas is a
7 competitive enterprise in terms of the fuel choices that consumers enjoy. In that
8 regard, natural gas is largely used as a heating fuel, which means that it competes with
9 heating oil, propane and electricity as a fuel source. Because it is a clean and efficient
10 fuel source, some level of natural gas system growth inevitably occurs as a result of
11 new construction and customer-initiated conversions. However, there are obstacles
12 that hinder the expansion of gas service, especially where no attempt is made to work
13 with the customer to make gas service a viable option at times when fuel choices are
14 made. The fundamental design and intent of the Gas Marketing Program is to educate
15 consumers about their choices and to facilitate the initiation of gas service where the
16 customer selects natural gas as a fuel source.

17 There are several factors that adversely affect the level of gas-service growth
18 experienced over time and require the implementation of focused education and
19 facilitation program. First, there is typically a higher initial cost for the installation of
20 natural gas equipment than oil replacements, particularly in the small

1 commercial/industrial and residential market sectors. At the same time, non-heating
2 gas customers are already connected to the distribution system, and therefore, these
3 types of customers represent a relatively low-cost opportunity to increase system
4 utilization if those customers can be motivated to select natural gas when considering
5 the replacement of electric or oil heat or domestic water-heating equipment. The
6 Company's experience has shown that it can overcome this obstacle on a cost-
7 effective basis by finding ways to help customers fund the cost of replacement
8 equipment and complete the installation process.

9 Second, it is difficult for the Company to compete with the customer-acquisition
10 efforts of the heating oil industry, especially in terms of the broad-based advertising
11 and promotional activities that heating-oil providers are permitted to take both
12 individually and as an industry. In addition, the Company has found that customers
13 often are relatively uninformed about the safety and affordability of natural gas
14 service. In terms of these two obstacles, the Company has found that comprehensive
15 customer education and outreach programs (which have not been undertaken in the
16 past in Rhode Island) go a long way in terms of informing the outcome of a
17 customer's fuel choice.

18 Lastly, it should be noted that the new construction market is a cyclical market that
19 generally does not provide a platform for increased system utilization on a stable and
20 sustained basis. Therefore, efforts to reach the low-use conversion market are

1 important in maintaining and achieving increased system utilization over time.
2 However, to reach this market, the Company needs to have an organized and effective
3 program to reach out and educate customers and to assist in their conversion needs.

4 For the Company, the core driver of the Gas Marketing Program is the realization that
5 system utilization cannot be maintained in the face of expanding conservation efforts,
6 unless a new program to encourage gas conversion along with conservation is
7 undertaken, especially in relation to existing low-use customers. This makes the Gas
8 Marketing Program a natural and proactive approach for National Grid to grow its
9 customer base for the benefit of customers, especially where customers have choices
10 in the marketplace and are aggressively solicited by unregulated purveyors of
11 alternative energy sources.

12 **Q. WHY IS THE SCALE OF OIL-HEAT MARKETING IN RHODE ISLAND OF**
13 **SIGNIFICANCE TO THE COMPANY?**

14 A. The oil heating industry in the Northeast is the best organized in the country. There
15 are approximately 100 oil dealers in Rhode Island that coordinate their local outreach
16 through a trade organization known as the Oil Heat Institute of Rhode Island. Some of
17 these companies are very large multi-state operations with customers from
18 Massachusetts to Virginia. Many form partnerships with real-estate agents. None of
19 these companies are subject to price regulation. The Northeast Oil Heat Research
20 Alliance, which is a national organization funded by a mandatory surcharge on heating

1 oil deliveries, has funds available to conduct consumer education and is doing so on a
2 proactive basis in the Rhode Island market. This advertising is in addition to local
3 campaigns conducted by individual oil dealers and oil equipment manufacturers and
4 distributors. The marketing efforts of these organizations include television
5 commercials, audio, video and print ads and other outreach.

6 Through the Gas Marketing Program, the Company would have the opportunity to
7 accomplish its own outreach to prospective customers so that customers have a more
8 balanced perspective on the options available to them as they consider their fuel
9 choices.

10 **Q. HOW WOULD THE GAS-MARKETING PROGRAM HELP TO ACHIEVE**
11 **ENVIRONMENTAL POLICY GOALS?**

12 A. Two factors are important in terms of environmental benefit, which are: (1) natural
13 gas is inherently a cleaner fuel than heating oil, and (2) state-of-the-art gas heating
14 equipment is more energy-efficient than late model oil-heating equipment. As a
15 result, direct environmental benefits would result from the increased use of natural gas
16 on a cost-effective basis. For that reason, National Grid views the Gas Marketing
17 Program as essential to its mission to provide strong leadership on energy-
18 management strategies and to safeguard the environment for future generations. In
19 addition, Rhode Island, like other jurisdictions within which the Company operates,

1 has taken several steps to achieve environmental policy objectives. These steps
2 include:

- 3 • Implementation of the Regional Greenhouse Gas Initiative (“RGGI”) Act for
4 the purpose of reducing greenhouse gas emissions, including carbon dioxide
5 emissions. RGGI specifically requires the adoption and use of cost-effective
6 energy-efficient products and programs and the strategic use of low and zero-
7 carbon energy resources;
- 8 • Establishment of the Rhode Island Office of Energy Resources to create plans
9 and programs to promote, encourage and assist the efficient and productive use
10 of energy resources in Rhode Island and to coordinate energy programs for
11 natural gas, electricity, and heating oil to maximize the aggregate benefits of
12 conservation and efficiency of investments;
- 13 • Establishment of the Rhode Island Energy Efficiency and Resource
14 Management Council to promote the optimization of energy efficiency, energy
15 conservation, energy resource development and diversification of energy
16 resources; and
- 17 • Establishment of the Permanent Joint Committee on Energy, which is charged
18 with promoting and encouraging the development of plans, programs and
19 strategies for energy conservation, energy efficiency and energy-resource
20 procurement, use and development.

21 Rhode Island has also taken steps targeted at electric and natural gas public utilities,
22 including:

- 23 • Mandating that the Rhode Island Public Utilities Commission make decisions
24 that (a) ensure an adequate and reliable energy supply at an economical cost
25 with regard for the preservation and enhancement of the environment, and
26 (b) provide fair regulation of public utilities and carriers in the public interest
27 to promote the availability of adequate, efficient and economical energy
28 services;
- 29 • Establishing that it is policy of the state to encourage, through all feasible
30 means and measures, the reduction of generation emissions over time to levels
31 that enable cost effective attainment of environmental standards within Rhode
32 Island; and

- 1 • Enacting the Energy and Consumer Savings Act of 2005, setting energy
2 efficiency standards to save energy and reduce pollution and other
3 environmental impacts associated with the production, distribution and use of
4 electricity and natural gas.

5 From these policy statements and initiatives, it is clear that the State of Rhode Island
6 has chosen to assume a proactive role in combating greenhouse emissions through
7 energy efficiency, energy conservation, energy resource development and the
8 diversification of energy resources. To that end, natural gas derives the most energy
9 from hydrogen of any fuel source, and as a result, generates approximately 26 percent
10 less greenhouse gases than equal use of other fuel sources according to the U.S.
11 Department of Environmental Protection. Therefore, when smaller customers replace
12 inefficient oil or coal-fired heating equipment with higher-efficiency natural gas
13 equipment, benefits are realized both in terms of reduced energy consumption and
14 reduced greenhouse gases, as compared to other fuel sources. These benefits are
15 realized even when customers are replacing older gas equipment with new gas
16 equipment, because of ever-evolving technological advances in gas-fired appliances.
17 The Gas Marketing Program is specifically designed to encourage and enable the use
18 of higher efficiency equipment and to reduce carbon emissions.

19 Therefore, if approved by the Commission, the Gas Marketing Program will serve as
20 an innovative, cost-effective and customer-friendly tool in reducing the State's carbon
21 footprint and meeting the Legislature's important public-policy goals, which is a rare
22 win/win situation for Rhode Island, the Company's customers and the Company given

1 its desire to be a leader on environmental issues while achieving value for
2 shareholders. As I stated above, the Company believes that this type of initiative is
3 long overdue.

4 **Q. ISN'T THE COMPANY CONCERNED THAT THE INCREASED USE OF**
5 **NATURAL GAS WILL SIMPLY PUT PRESSURE ON AVAILABLE**
6 **NATURAL GAS SUPPLIES AND PROVIDE THE IMPETUS FOR**
7 **INCREASES IN THE COST OF GAS?**

8 A. Although National Grid is acutely aware of the pressure that customers feel as a result
9 of increasing energy costs, it is also recognizes that energy prices are set within
10 national and global markets and are a function of a range of influences that are beyond
11 the Company's control. There is no potential for the Gas Marketing Program to
12 impact the national and global supply-demand balance and cause price increases or
13 volatility. In fact, given the level of load conservation that the Company is
14 experiencing, and will continue to experience with the implementation of new energy
15 efficiency programs, the increased system utilization gained through the Gas
16 Marketing Program will simply offset or replace system utilization lost through
17 conservation. Any net increase that did occur would be miniscule in comparison to
18 the national energy markets.

19 For this reason, National Grid recognizes that the *efficient* use of natural gas (and
20 electricity) is the customer's best opportunity to manage and reduce energy costs. As

1 explained in the testimony of Mr. Stavropoulos, National Grid is deeply committed to
2 the twin ideals of energy efficiency and the development of sustainable energy
3 strategies. Although energy efficiency and demand-side load management are
4 relatively new concepts in Rhode Island in terms of regulatory mandates, the
5 Company has an unparalleled breadth of experience with natural gas energy efficiency
6 programs in other jurisdictions in which it provides gas service.

7 In the long run, the Company believes that natural gas is the fuel of choice both from
8 an environmental perspective and in terms of assuring reliable access to competitively
9 priced sources of energy supply.

10 **III. PROGRAM COMPONENTS**

11 **Q. WOULD YOU PLEASE PROVIDE AN OVERVIEW OF THE GAS-**
12 **MARKETING PROGRAM?**

13 A. As noted above, the Gas Marketing Program is targeted at motivating conversions to
14 gas service by two types of customers within both the residential and C&I sectors,
15 which are: (1) low-use, existing gas customers who are already connected to the
16 Company's system through a previously installed service, and (2) new customers who
17 are located on the Company's existing distribution system and are seeking to replace
18 appliances or heating equipment that are not gas-fired. These two types of customers
19 present the greatest opportunity for cost-effective load growth because there is no need

1 to install distribution mains to serve the customer premises. The Gas Marketing
2 Program is not targeted at new construction because, where natural gas is available, it
3 is the choice of builders more than 95 percent of the time.

4 In terms of program design, the Gas-Marketing Program involves four components
5 each of which is aimed at addressing one or more of the obstacles that currently
6 discourage the choice of natural gas as a heating or process fuel. These program
7 components are as follows:

- 8 i. Customer Outreach and Education
- 9 ii. Installation Support
- 10 iii. Discounted Equipment
- 11 iv. Equipment Rebates

12 Each of these components plays a singular role in achieving the overall objectives of
13 the program, as described below.

14 **Q. WHAT TYPE OF CUSTOMER OUTREACH AND EDUCATION DOES THE**
15 **COMPANY ANTICIPATE WOULD BE UNDERTAKEN?**

16 A. One of the largest obstacles that the Company confronts in terms of expanding gas
17 service to low-use of new conversion customers is customer outreach and
18 communication. As noted above, it is extremely difficult for the Company to compete
19 with the customer-acquisition efforts of the heating oil industry, especially in terms of
20 the broad-based advertising and promotional activities that heating-oil providers are

1 allowed to take both individually and as an industry. In addition, the Company has
2 found that customers often are relatively uninformed about the safety and affordability
3 of natural gas service. In terms of these two obstacles, the Company has found that
4 comprehensive customer education and outreach programs (which have not been
5 undertaken in the past in Rhode Island) go a long way in terms of shaping the outcome
6 of a customer's fuel choice.

7 In New York, Massachusetts and New Hampshire, the Company utilizes a wide range
8 of communication channels to reach out to customers and provide information
9 regarding natural gas service and the opportunities available to them as part of a gas
10 conversion. These communications include direct mail, print and visual media and
11 radio. These communications are generally targeted at small and medium C&I
12 customers and residential customers because larger customers are fewer and tend to be
13 more proactive and informed regarding their energy choices. Therefore, the Company
14 can seek out these types of customers individually and there is less need to expend
15 valuable resources on their education. A portion of the outreach and education budget
16 would be devoted to ethnic communities so that information is as broadly and fairly
17 available as possible.

18 The communication plan undertaken through the Gas Marketing Program will also
19 include an aspect of "lead generation," which refers to the Company's opportunity to
20 identify potential conversion candidates and to pass those contacts on to local

1 plumbing and heating contractors participating in the Company's program so that
2 those entities can complete the installation process. This aspect of the Gas Marketing
3 Program is referred to as the "ValuePlus Program," which is discussed below.

4 **Q. WHAT TYPE OF INSTALLATION SUPPORT WOULD THE COMPANY**
5 **PROVIDE?**

6 A. The Company intends to provide installation support services through the Value Plus
7 Installer Program ("VPI") to customers who have not yet identified a plumbing and
8 heating contractor to assist in their installation or conversion. The VPI Program is an
9 innovative program that is designed to provide assistance to residential customers
10 electing to convert to gas service and to create a high level of customer satisfaction
11 with the gas-conversion process. The VPI Program involves a contractor-referral
12 system that facilitates the Company's handling of sales leads routinely received from
13 customers requesting on-main gas conversions or low-use upgrades. The program
14 achieves this objective by creating a link between the Company and qualified
15 plumbing and heating contractors in the communities that the Company serves.

16 For example, potential customers who are contemplating converting to gas service
17 generally will contact the Companies to discuss the safety of natural gas, facility
18 installation, pricing alternatives and a number of other issues related to the potential
19 conversion. In such instances, the company sales representative will work with the
20 customer to analyze the customer's particular circumstances and determine the

1 feasibility of converting to gas service. In other cases, a customer may contact the
2 Company regarding the replacement of existing hot water or heating equipment. In
3 either case, customers frequently ask the Company to refer a qualified contractor to
4 perform the services necessary to accomplish the customer's objectives. Referring a
5 qualified and experienced contractor to the customer results in a high level of
6 customer satisfaction and convenience and facilitates the Company's efforts to
7 increase system utilization in a cost-effective manner through low-use upgrades and
8 on-main conversions.

9 If the customer does not already have an installation contractor, the Company will
10 offer to schedule an appointment with a participating VPI contractor. National Grid
11 schedules customer appointments with participating contractors on a rotating basis.
12 All qualified contractors able to do gas installations in a geographic location will be
13 invited and encouraged to participate in the VPI program. Only contractors who have
14 submitted proof of insurance will be eligible for participation in the program.

15 **Q. WHAT IS THE DISCOUNTED EQUIPMENT PROGRAM?**

16 A. The Gas Marketing Program has been in place in New York, Massachusetts and New
17 Hampshire for some time. To facilitate the objectives of the program, the Company
18 has developed bargaining relationships with various manufacturers of quality gas
19 heating and cooling equipment for the purchase of equipment in large quantities,
20 which is then available for resale to customers participating in the program. Because

1 the Company is purchasing equipment in large quantities, it is able to negotiate a
2 substantial bulk discount. Purchased equipment is then offered to customers through
3 the Gas Marketing Program at a price that reflects both the Company's bulk-purchase
4 discount and also a further discount made available through the Gas Marketing
5 Program to enable customer conversions to gas service. Because the cost of gas
6 conversions can be higher than other fuel options available to the customer, the
7 combination of the bulk purchasing discount and the program discount provide a
8 valuable incentive to customers considering a switch to gas service. In the Company's
9 experience, the discounted equipment component of the Gas Marketing Program is a
10 critical and indispensable tool in achieving the goals of the program. Customers will
11 switch to gas service if they can afford to do so, and when they do switch, benefits
12 result for all existing customers on the system because those new billing units are now
13 available to support the cost of service.

14 **Q. WHAT TYPE OF EQUIPMENT REBATES WOULD BE OFFERED?**

15 A. Customers who would prefer to purchase gas-heating equipment from a manufacturer
16 that is not part of the Company's bulk purchasing program would be eligible for a
17 rebate of equal value to the program discount offered on equipment purchased by the
18 Company from its manufacturing suppliers. This ensures that customers are able to
19 obtain the same program incentive, while maintaining the choice of equipment to be
20 used in their home or business. As with the equipment discount, the Company's

1 experience has shown that this component is vital to the success of the Gas Marketing
2 Program.

3 **Q. CAN YOU BE MORE SPECIFIC AS TO THE REASONS THAT EQUIPMENT**
4 **DISCOUNTS AND REBATES ARE A NECESSARY COMPONENT OF THE**
5 **GAS MARKETING PROGRAM?**

6 A. There are several reasons that equipment discounts and rebates are an indispensable
7 part of the Gas Marketing Program. As noted above, there is typically a higher initial
8 cost for the installation of natural gas equipment than oil replacements, particularly in
9 the small commercial/industrial and residential market sectors. For example,
10 residential customers may need to include the costs of re-lining the home's chimney
11 and the removal or securing of an oil storage tank, which in turn reduces risk and
12 liability for the homeowner and surrounding premises. These costs are incremental to
13 the costs that the customer or potential customer would incur for an oil-to-oil
14 equipment replacement, and therefore, is a significant obstacle that must be overcome
15 in order to motivate new gas conversions. The Company's experience has shown that
16 offering assistance to customers in overcoming the price barrier is a cost-effective way
17 to secure the gas conversion and to achieve a higher level of system utilization.

1 additions and conversions. As explained in the next section, this is the same test that
2 the Company is seeking to apply as a threshold for base-rate recovery in Rhode Island.

3 **IV. PROGRAM ECONOMICS**

4 **Q. WHAT IS THE COMPANY'S PROPOSAL FOR COST RECOVERY IN THIS**
5 **PROCEEDING IN RELATION TO THE GAS MARKETING PROGRAM?**

6 A. The Company's cost-recovery proposal in this proceeding involves three steps: First,
7 the Company proposes to demonstrate in this proceeding that the annual revenues
8 made available to the system over the service life of the new or converted customers
9 would exceed the cost of adding those customers to the system based on an internal
10 rate of return analysis determining the "cost effectiveness" of forecasted customer
11 additions. Second, the Company proposes to include the program costs used in the
12 cost-effectiveness calculation in the revenue requirement to be recovered through base
13 rates as a post-test year adjustment. Third, the Company proposes to increase post
14 test-year sales revenues to include forecasted customer additions resulting from the
15 program budget. This last step guarantees that customers will obtain the "benefit of
16 the bargain" in paying the program costs through rates.

17 **Q. HOW IS THE COMPANY PROPOSING TO DEMONSTRATE THAT THE**
18 **GAS MARKETING PROGRAM IS COST EFFECTIVE?**

19 A. Please refer to Attachment NG-SPM-1 setting forth the cost-effectiveness calculation,

1 which is based on an “internal rate of return” (“IRR”) standard to establish that the
2 system growth is beneficial to customers. To perform this analysis, the Company has
3 relied on its substantial experience with the program in other jurisdictions, which
4 makes available information on several criteria included in the IRR such as customer
5 response rates, the period of return of invested capital and estimated load additions.

6 As shown in Attachment NG-SPM-1, the cost-effectiveness calculation is performed
7 separately for the residential and non-residential customer sectors. For each customer
8 sector, the Company has first estimated the number of customers that would become
9 new or converted gas customers *each year* in Column (A). The number of customers
10 is estimated based on the range of the Company’s experience in other jurisdictions
11 scaled to relate proportionally to the size of the Rhode Island customer base. Second,
12 in Column (B), the Company estimated the number of customer services that would be
13 required to provide the requested gas service to the new or converted customer. Third,
14 in Column (C), the Company has identified the average expected margins for each
15 new or converted customer based on currently effective distribution rates, which
16 reflects estimated annual usage for each customer sector (and type within the
17 residential sector) based on the Company’s experience. This average margin is also
18 included in the Company’s revenue forecast presented by Mr. Czekanski.

19 Next, in Column (D), the Company first multiplied the estimated number of customers
20 by the total average *annual* margin anticipated for the new or converted customers

1 added to the system in the annual period based on currently effective distribution rates.

2 In Column (E), the Company has listed the capital costs associated with connecting
3 the new or converted customers to the system. These costs total \$3,638,660 million
4 annually for both the residential and C&I sectors, and are included in the capital
5 forecast discussed in the testimony of Mr. Laflamme. Column (F) presents the O&M
6 expense that is proposed for inclusion in the revenue requirement. These costs total
7 \$1,377,000 per year in aggregate for the residential and C&I customer sectors and are
8 included in Mr. Laflamme's revenue-requirement calculation. Column (G) states the
9 customer contribution included in the calculation for the residential customer sector.

10 The cost-effectiveness analysis is based on an "internal rate of return" standard. In
11 Column (H), the Company has calculated the internal rate of return assuming that both
12 residential and C&I customers remain on the system for a period of 20 years once
13 added or converted to the system, which is consistent with the Company's experience.
14 The IRR analysis also assumes that new residential heating conversion customers are
15 contributing \$450 toward their hookup and residential non-heating customers are
16 contributing \$1,500 toward their hookup. This represents a significant reduction from
17 the currently effective contribution required from customers. Contributions for C&I
18 customers would be determined on a customer-specific basis to take into account the
19 special requirements of those customers.

1 Based on a 20-year investment return period, the identified capital and O&M costs and
2 the customer contribution, the Company's analysis shows that residential customer
3 additions will produce an IRR of approximately 14.8 percent, and new or converted
4 C&I customers will produce an IRR of 21.4 percent. From a ratemaking perspective,
5 this means that these new or converted customers will add sales revenues in excess of
6 the Company's allowed rate of return, effectively reducing the sales revenues that
7 need to be recovered from other customers in order to meet the rate of return set by the
8 Commission in this docket.

9 By using an IRR calculation to compare revenues to costs, the Company is able to
10 determine both on a project-specific basis, as well as in the aggregate, whether the
11 benefits of a new customer addition outweighs the cost associated with attracting that
12 customer through promotional incentives and rebates and the incurrence of direct and
13 indirect costs associated with installing mains, services and meters needed to connect
14 the new load to the distribution system. The Company designed this calculation to be
15 consistent with its internal methodologies for determining the cost effectiveness of its
16 system-growth rate-base investments. The IRR calculation demonstrates that the
17 Company's existing body of customers will receive a direct benefit from the Gas
18 Marketing Program because the rate of return is greater than the Company's weighted
19 average cost of capital.

1 **Q. HOW WILL THE RATES APPROVED BY THE COMMISSION IN THIS**
2 **PROCEEDING AFFECT THE IRR CALCULATION?**

3 A. As noted above, the IRR calculations set forth in Attachment NG-SPM-1 include a
4 calculation of the average margin estimated to result from the addition of a typical
5 residential or C&I customer based on *currently effective* rates. If the average usage for
6 new residential or C&I customers is multiplied by the rates approved by the
7 Commission in this proceeding, the resulting IRR would be higher. Therefore, in
8 basing the IRR calculation on existing rates, the Company has presented a
9 conservative analysis of the benefits available to the Rhode Island customer base as a
10 result of the program implementation. With a higher IRR resulting from new rates, it
11 would be possible to lower the customer contribution even further from current levels,
12 which in turn would have the effect of further promoting customer conversions.
13 Therefore, the Company is proposing to set the final customer contribution based on
14 the rates approved by the Commission and to submit a revised Application for Natural
15 Gas Policies and Procedures containing the updated customer contribution in the
16 Company's compliance filing for this proceeding.

17 **Q. WHAT ARE THE PROGRAM COSTS THAT THE COMPANY PROPOSES**
18 **TO INCLUDE IN BASE RATES?**

19 A. As shown in Attachment NG-SPM-1, the Company is proposing to include both
20 capital and O&M costs in the revenue-requirement calculation for recovery through

1 rates. The capital costs include the net cost of connecting the customer to the system
2 or upgrading existing connections to allow for gas service). The “net cost” is the cost
3 of capital investment, less the contribution made by the customer. The O&M
4 expenses proposed for inclusion in rates would recover the cost of customer
5 communication, education and outreach and the cost of discounts or rebates provided
6 customers for participation in the program. To offset these costs, the Company is also
7 proposing to include the revenues that are estimated would be added to the system
8 each year as a result of customer additions. In fact, based on the IRR calculation, the
9 revenues available to the system more than offset the program costs, providing a net
10 benefit to customers.

11 **Q. SPECIFICALLY, HOW HAS THE COMPANY FACTORED THE SALES**
12 **INCREASES THAT ARE PROJECTED TO RESULT FROM THE PROGRAM**
13 **INTO ITS SALES FORECAST IN THIS PROCEEDING?**

14 A. As discussed in the testimony of Mr. Czekanski, the Company has projected the
15 customer additions that are expected to result from implementation of the Gas
16 Marketing Program and has included those sales revenues in the revenue requirement
17 presented by Mr. Laflamme. By including these projected sales revenues in the
18 revenue requirement put forth in this proceeding, the Company is guaranteeing
19 customers the rate benefit from the volumes forecasted to be achieved through the
20 program.

1 V. CONCLUSION

2 Q. DO YOU HAVE ANY OTHER COMMENTS ON THE GAS MARKETING
3 PLAN?

4 A. Yes. I would like to emphasize that National Grid views the Gas Marketing Program
5 as a critical initiative for its Rhode Island customers. Based on the Company's actual
6 experience in New York, Massachusetts and New Hampshire, the Gas-Marketing
7 Program is a proven and successful strategy for obtaining net growth benefits for
8 customers, while also serving environmental policy goals. This is especially true
9 where there is strong movement toward the development of an aggressive energy
10 efficiency and conservation program, which National Grid strongly supports. The Gas
11 Marketing Program will prove to be an important complement to the Company's
12 energy efficiency and decoupling efforts.

Attachment

Attachment NG-SPM-1

Program Economics – Financial Review of
Incremental Investments

Program Economics - Financial Review of Incremental Investments

	(A) Customer s	(B) Number of Services	(C) Average Margin	(D) Total Incremental Margin	(E) Total Capital	(F) Total O&M	(G) Customer Contribution	(H) Internal Rate of Return
Residential Markets								
New Heating Conversions	950	790	423	\$ 401,850	\$ 1,785,900		\$ 450	
New Non-Heating	50	50	171	\$ 8,550	\$ 58,000		\$ 1,500	
<i>New Accounts:</i>	1000	840		\$ 410,400	\$ 1,843,900			
Low Use Conversion to Heat	700	50	252	\$ 176,400	\$ 120,500			
Subtotal	1700	890		\$ 586,800	\$ 1,964,400	\$ 1,124,500		14.8%
Commercial and Industrial Markets								
New Small (up to 500 dth/yr)	245	158	569	\$ 139,405	\$ 1,296,020			
New Medium (501-3500 dth/yr)	75	46	3249	\$ 243,675	\$ 378,240			
<i>New Accounts:</i>	320	204		\$ 383,080	\$ 1,674,260			
Business Added Load /no pipe	200	0	750	\$ 150,000				
Subtotal	520	204		\$ 533,080	\$ 1,674,260	\$ 252,500		21.4%
Total Program Additions								
Total	2220	1094		\$ 1,119,880	\$ 3,638,660	\$ 1,377,000		17.5%