

**PRE-FILED DIRECT TESTIMONY**

**OF**

**NICKOLAS STAVROPOULOS**

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1    **I. INTRODUCTION**

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

3    A. My name is Nickolas Stavropoulos. My business address is 52 Second Avenue,  
4    Waltham, MA 02451.

5    **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6    A. I am the Executive Vice President of Gas Distribution-US for National Grid with  
7    responsibility for the Company's regulated gas distribution operations in Rhode  
8    Island, Massachusetts, New Hampshire and New York.

9    **Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND**  
10   **AND YOUR BUSINESS EXPERIENCE.**

11   A. I graduated from Bentley College in 1979 with a Bachelor of Science in  
12   Accounting. Subsequently, I earned a Masters of Business Administration from  
13   Babson College. In 1979, I joined Colonial Gas Company as an analyst in the rates  
14   and accounting areas. In 1982, I was promoted to Assistant Controller. In 1985, I  
15   was named Vice President of Rates and Planning. In 1989, I was named Vice  
16   President and Chief Financial Officer. In 1995, I became Executive Vice President  
17   of Finance and Marketing in addition to Chief Financial Officer, and I assumed  
18   responsibility for all of Colonial's financial, marketing, information technology and  
19   customer-service functions. In 1999, following the acquisition of Colonial by  
20   Eastern Enterprises (parent company of Boston Gas Company), I was named Senior

1 Vice President of Marketing and Gas Resources for Eastern's regulated gas  
2 distribution companies. When KeySpan Corporation acquired Eastern Enterprises  
3 in 2000, I was named KeySpan's Senior Vice President of Sales and Marketing for  
4 New England. I was subsequently named Executive Vice President of KeySpan  
5 Corporation and President of KeySpan Energy Delivery with responsibility for  
6 KeySpan's 2.6 million natural gas customers in New Hampshire, New York and  
7 Massachusetts. Following the National Grid PLC acquisition of KeySpan  
8 Corporation, I was named to my current position.

9 **Q. WHAT ARE YOUR PRINCIPAL RESPONSIBILITIES AS EXECUTIVE**  
10 **VICE PRESIDENT OF GAS DISTRIBUTION-US?**

11 A. As Executive Vice President of Gas Distribution-US, I am the senior officer  
12 responsible for the safe and reliable operation of the U.S. gas distribution system  
13 now owned by National Grid. I am responsible for overseeing approximately 6,000  
14 employees in New York and New England who perform all of the field work for  
15 maintenance, construction and operation of the gas distribution system, as well as  
16 the Network Strategies group, which encompasses engineering, reliability and  
17 integrity planning. I also oversee the Company's LNG operations and the support  
18 functions associated with gas operations.

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

20 A. The purpose of my testimony is to introduce the Company's overall business  
21 operating plan for its Rhode Island natural gas distribution operations and to

1 describe how the Company's proposals in this proceeding are designed to further  
2 the interests of customers within that context. Specifically, my testimony is  
3 organized as follows: Section II describes the National Grid operating structure, as  
4 organized following the completion of the merger with KeySpan Corporation, and  
5 also outlines the Company's perspective and strategy for providing safe, reliable  
6 and least cost service to customers. Section III outlines the Company's principal  
7 proposals in this proceeding and discusses how those proposals help to achieve the  
8 Company's operating objectives and public-service obligations.

9 **Q. WHAT IS THE COMPANY REQUEST FOR BASE-RATE RELIEF IN THIS**  
10 **PROCEEDING AND WHAT ARE THE FACTORS MOTIVATING THIS**  
11 **REQUEST?**

12 A. In this proceeding, the Company is seeking to recover an annual revenue deficiency  
13 of approximately \$20.04 million based on a rate base of approximately \$285  
14 million. This proposal represents an increase of approximately 5.1 percent in the  
15 total annual bill for the average residential heating customer, but is only the first  
16 gas-distribution rate increase in ten years. In making this request, the Company is  
17 acutely aware that it is difficult to raise rates for customers, especially in a  
18 challenging economic environment. However, the Company is facing the need to  
19 increase its investment in the gas distribution infrastructure in Rhode Island in order  
20 to replace aging mains and services. Replacing this aging infrastructure will  
21 produce long-term benefits for customers in the form of reducing gas costs through

1 the elimination of gas leaks, as well as significantly increasing the safety and  
2 reliability of the system. In addition, the reduction of gas leaks provides a corollary  
3 benefit in terms of reducing harmful carbon emissions consistent with important  
4 environmental objectives.

5 In addition to the need to address infrastructure replacement, there are other factors  
6 outside of the Company's control that have had an impact on the Company. First,  
7 the Company is experiencing the cumulative impact of inflation over the 7-year  
8 period between the test year used in the Company's last base-rate case and the test-  
9 year ending September 2007 in this case, which has increased the overall cost of  
10 goods and services by approximately 21 percent. At the same time, customer-  
11 initiated conservation efforts and energy-efficiency improvements have  
12 substantially deteriorated the revenues generated through the Company's existing  
13 base rates, with annualized lost revenues totaling \$7.6 million since June 2004 for  
14 the residential heating class alone. Unfortunately, in light of increasing O&M  
15 costs, declining revenues per customer and ongoing capital requirements, the  
16 Company has exhausted available opportunities to avoid an increase in rates, and  
17 therefore, finds it necessary to make a request for base-rate relief at this point in  
18 time.

19 In this filing, the Company has set forth a series of proposals that, on a collective  
20 basis, are designed to deal directly with the factors that currently make it difficult to  
21 maintain an adequate level of cost recovery and rate stability over time. If

1 approved by the Commission, these proposals would restore the Company's ability  
2 to fund utility operations on a going forward basis without the need for repeated  
3 rate cases, and in doing so, would directly serve the interest of Rhode Island  
4 customers in having access to safe and reliable gas service, at the lowest reasonable  
5 cost over the long term.

6 **Q. WOULD YOU PLEASE PROVIDE AN OVERVIEW OF THE COMPANY'S**  
7 **WITNESS TESTIMONY INCLUDED IN THE FILING?**

8 A. Yes. The Company's filing is set forth in the testimony of nine witnesses, in  
9 addition to my own. These testimonies are as follows:

- 10 • **Michael D. Laflamme** is the Director of Revenue Requirements for National  
11 Grid USA Service Company. Mr. Laflamme's testimony sets forth the  
12 calculation of the revenue requirement and resulting revenue deficiency. Mr.  
13 Laflamme's testimony also discusses how merger-related savings are accounted  
14 for in the Company's proposed rates and discusses the proposed ratemaking  
15 treatment for incremental capital requirements and pensions and post-retirement  
16 benefits other than pensions ("PBOP").
- 17 • **Susan L. Fleck** is the Vice President of Engineering Standards and Policy for  
18 National Grid. Ms. Fleck's testimony describes the rigorous evaluation of the  
19 gas distribution system in Rhode Island undertaken by National Grid upon  
20 acquisition of the Rhode Island properties and the Company's proposal to  
21 accelerate certain capital programs historically conducted by the gas company

- 1 in order to enhance the safety and reliability of the distribution system.
- 2 • **Sean P. Mongan** is Director of Operations and Process Support for the Energy  
3 Solutions Service group within National Grid. Mr. Mongan’s testimony  
4 presents the Company’s proposal to initiate a Gas Marketing Program in Rhode  
5 Island to facilitate conversions to natural gas service so that the fixed costs of  
6 the distribution system would be spread across a larger customer base over time.
- 7 • **Paul R. Moul** is the principal of P. Moul and Associates. Mr. Moul’s testimony  
8 presents the Company’s capital structure and cost of capital analysis.
- 9 • **Dr. Kimbugwe A. Kateregga** is Vice President and Consultant of Foster  
10 Associates, Inc. Dr. Kateregga’s testimony presents the Company’s  
11 depreciation study and proposed depreciation rates for ratemaking purposes.
- 12 • **Alan V. Feibelman and Richard J. Levin** are employed as a Director and  
13 Management Consultant, respectively, with Oliver Wyman, the successor  
14 company to Mercer Management Consulting. The joint testimony of Mr.  
15 Feibelman and Mr. Levin discusses the National Grid/KeySpan integration  
16 planning effort and the resulting estimated synergy savings and costs to achieve.
- 17 • **James D. Simpson** is Vice President with Concentric Energy Advisors, Inc.  
18 Mr. Simpson’s testimony presents the Company’s proposal for a revenue  
19 decoupling mechanism, which is designed to provide a platform for the ramp-up  
20 of energy efficiency and conservation efforts by rendering the Company’s  
21 revenues neutral to reduced usage on a per-customer basis.

- 1       • **David A. Heintz** is Assistant Vice President with Concentric Energy Advisors,  
2       Inc. Mr. Heintz’s testimony presents the Company’s allocated cost of service  
3       study and proposed rate design. Mr. Heintz’s testimony also introduces the  
4       Company’s proposed low-income distribution rate for customers meeting  
5       federal poverty guidelines.
- 6       • **Peter C. Czekanski** is Manager of Pricing for National Grid. Mr. Czekanski’s  
7       testimony outlines the Company’s test year and rate year billing determinants  
8       and revenues, the introduction of a low-income residential distribution rate and  
9       proposed changes to the Company’s Gas Cost Recovery Clause, Distribution  
10      Adjustment Charge tariff, non-firm service offerings and other miscellaneous  
11      tariff changes.

12   **II. NATIONAL GRID OPERATING STRUCTURE**

13   **Q. WOULD YOU PLEASE DESCRIBE THE OPERATING STRUCTURE FOR**  
14   **NATIONAL GRID AND EXPLAIN HOW THE RHODE ISLAND**  
15   **OPERATIONS FIT WITHIN THE OVERALL STRUCTURE?**

- 16   A. Yes. National Grid US is a wholly owned subsidiary of National Grid plc, a UK-  
17   based company whose stock is traded on the London Stock Exchange. Prior to its  
18   acquisition of KeySpan Corporation, National Grid US operated five local  
19   distribution companies serving more than 4 million electric and natural gas  
20   customers in New York, Massachusetts, New Hampshire and Rhode Island.  
21   KeySpan Corporation operated natural gas local distribution companies in New

1 York, New Hampshire and Massachusetts, serving approximately 3.0 million  
2 customers. In addition, KeySpan maintained the electric-distribution system on  
3 behalf of the Long Island Power Authority, which provides electricity to 1.1 million  
4 customers on Long Island. Over the long term, the combination of these two  
5 systems within National Grid's global operations will provide a significant  
6 opportunity to leverage the Company's size, scope, resources and expertise in areas  
7 such as materials purchasing, infrastructure installation and maintenance processes,  
8 commodity procurement, environmental remediation, customer-service  
9 enhancements, delivery of energy efficiency programs and programs to assist low  
10 income customers.

11 Following the KeySpan acquisition, National Grid established an organizational  
12 structure encompassing global business units including: (1) Transmission; (2) Gas  
13 Distribution; (3) Electric Distribution and Generation; (4) Business Development  
14 and Non-Regulation Operations, and (5) Finance and Shared Services. Although  
15 currently organized as part of the legal entity known as The Narragansett Electric  
16 Company, the Rhode Island gas operations are managed within the National Grid  
17 operating structure as part of the Gas Distribution Unit, which falls within my  
18 responsibility as Executive Vice President of Gas Distribution. This organizational  
19 structure is designed to ensure optimal operating efficiency and to leverage the gas-  
20 distribution technical expertise and resources that exist both within the former  
21 KeySpan operation and National Grid for the benefit of gas customers.

1 **Q. WHAT IS NATIONAL GRID’S VISION IN TERMS OF ITS LOCAL**  
2 **OPERATIONS, NOW THAT THE MERGER WITH KEYSpan IS**  
3 **COMPLETE?**

4 A. National Grid’s overall vision is to become the recognized leader in delivering  
5 electricity and natural gas with unparalleled efficiency, reliability and safety in  
6 order to promote the well being of customers and the communities in which they  
7 reside. Coincident with this customer commitment, National Grid is aiming to  
8 establish itself as an innovator in energy-management strategies and long-term  
9 sustainability efforts to safeguard the global environment for future generations.

10 National Grid is planning to fulfill this vision at the local level through the  
11 implementation of a multi-pronged effort to establish and maintain operating  
12 integrity, to create and facilitate energy-management strategies by customers and to  
13 grow the distribution system on an economic basis to spread fixed costs over a  
14 larger base. For Rhode Island, the Company is proposing to achieve these  
15 challenging objectives through increased system investment, the implementation of  
16 a revenue decoupling mechanism to facilitate and support the energy efficiency and  
17 conservation program recently adopted by the Rhode Island legislature, as well as  
18 the commencement of a targeted program to increase the number of customers  
19 taking gas service from the existing distribution system so that the costs of that  
20 system are shared by a greater number of customers. As explained in the testimony  
21 of Mr. Sean P. Mongan, the Company’s proposal for encouraging natural gas

1 conversions to achieve a higher level of system utilization will also serve key  
2 environmental goals to reduce carbon emissions. Lastly, the Company is proposing  
3 to create a new, low-income discount rate for residential customers in order to  
4 provide some assistance to those customers who meet federal poverty guidelines.

5 **Q. WHAT IS THE MOST FORMIDABLE CHALLENGE THAT THE**  
6 **COMPANY FACES IN WORKING TO MEET ITS PUBLIC-SERVICE**  
7 **OBLIGATION TO OPERATE THE SYSTEM ON A SAFE AND RELIABLE**  
8 **BASIS?**

9 A. As I stated above, the Company is currently facing a formidable challenge in terms  
10 of maintaining a sufficient stream of revenues to recover the revenue requirement  
11 associated with the safe and reliable provision of gas service to customers.  
12 Attachment NG-MDL-1, which is submitted as part of Mr. Laflamme's testimony,  
13 shows that the Company earned a rate of return of 4.5 percent for the normalized  
14 test year ended September 30, 2007, which is substantially less than the return of  
15 11.4 percent approved as part of the allowed revenue requirement in the Company's  
16 last base-rate case, and is far below any reasonable rate of return ever approved by  
17 the Commission.

18 The Company's analysis shows that the major factors prohibiting the Company  
19 from recovering its allowed revenue requirement are increasing O&M costs,  
20 declining use per customer and the need to increase capital investment to accelerate  
21 the replacement of aging distribution infrastructure. These factors would not be

1 addressed by the Commission’s approval of a base-rate request in this case based  
2 exclusively on the historical cost of service and, as a result, the Company would  
3 likely confront the need to file a subsequent request for base-rate relief within short  
4 order. Because it is in the interests of both the Company and its customers to  
5 achieve a level of continuity and stability in the ratemaking process, the Company is  
6 proposing in this case to implement certain mechanisms that address these factors  
7 directly in order to stabilize the revenue stream necessary to recover the allowed  
8 revenue requirement and avoid the need for frequent base-rate cases. As explained  
9 below, these proposals would work to inhibit the revenue erosion that would  
10 otherwise occur, while also placing an emphasis on accelerated capital investment,  
11 beneficial system utilization, promotion of customer conservation and energy  
12 efficiency efforts and low-income assistance. In addition, the Company is  
13 proposing to implement a multi-year rate plan that would mitigate the bill impacts  
14 for customers resulting from the correction of base rates in this proceeding and  
15 provide additional impetus for the avoidance of base-rate increases in the future.

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1 **III. OVERVIEW OF COMPANY PROPOSALS**

2 **Q. WOULD YOU PLEASE PROVIDE AN OVERVIEW OF THE COMPANY'S**  
3 **PROPOSALS IN THIS PROCEEDING TO AVOID FUTURE RATE CASES**  
4 **AND ACHIEVE A LEVEL OF CONTINUITY AND STABILITY FOR THE**  
5 **COMPANY AND ITS CUSTOMERS?**

6 A. Yes. As I briefly mentioned above, the Company is making several interrelated  
7 proposals in this proceeding, which are designed to inhibit the revenue erosion that  
8 would otherwise occur following the completion of this proceeding, while also  
9 placing greater emphasis on accelerated capital investment, beneficial system  
10 utilization, promotion of customer conservation and energy efficiency efforts and  
11 low-income assistance. The Company's specific proposals encompass the  
12 following:

- 13 ○ Revenue Decoupling
- 14 ○ Cost-Effective System Utilization
- 15 ○ Accelerated Capital Investment
- 16 ○ Treatment of Merger-Related Synergies
- 17 ○ Low-Income Distribution Rates

18 On an individual basis, implementation of each of these elements is critical both to  
19 the success of the Company's overall plan for the Rhode Island operations as an  
20 integrated component of the National Grid operating system. In combination, these  
21 proposals will create an effective ratemaking paradigm to provide a level of

1 continuity and stability in the ratemaking process for the benefit of customers over  
2 the long term.

3 **Q. IN GENERAL, WHAT IS THE COMPANY’S PROPOSAL FOR**  
4 **REVENUE DECOUPLING?**

5 A. The Company’s specific proposal for decoupling is set forth in the testimony of  
6 Mr. James D. Simpson. In sum, it is designed to facilitate the expansion of gas  
7 efficiency programs by removing the Company’s dependency on increasing gas  
8 consumption by its customers in order to obtain the revenue needed for safe and  
9 reliable operation. The Company’s decoupling proposal accomplishes this  
10 objective through a combination of two changes. First, the company is proposing  
11 to re-design some of its rates to recover more of its distribution revenue through  
12 fixed charges instead of usage-dependent charges. Second, the Company is  
13 proposing a reconciling “revenue per customer” approach to recover its annual  
14 revenue requirement. The detailed mechanics are more fully explained by Mr.  
15 Simpson.

16 **Q. WHAT IS THE REASON FOR THIS PROPOSAL?**

17 A. The primary reason for the Company’s proposal is to advance the goal of  
18 achieving greater energy efficiency in the State of Rhode Island. By way of  
19 background, this Commission and governmental leaders in the State of Rhode  
20 Island have recognized the need for increased energy efficiency programs. The  
21 Rhode Island legislature recently passed legislation requiring the implementation

1 of new gas-efficiency programs. National Grid is a strong supporter of gas  
2 efficiency programs and firmly believes in the public policy of encouraging  
3 customers to substantially reduce their use of the product delivered by the  
4 Company every day. Gas efficiency programs help customers to manage their  
5 energy costs and also provide environmental benefits by reducing carbon  
6 emissions. Although the programs to be offered to Rhode Island customers are  
7 not the subject of this proceeding, the anticipated ramp-up of gas-efficiency  
8 programs will have an impact on the Company's revenues and, thus, is related to  
9 this case.

10 It is indisputable that, as the Company moves aggressively to advance the public  
11 policy objectives of increased efficiency, the Company's revenues will be  
12 reduced. National Grid has already experienced this dynamic in dramatic form on  
13 the gas side of the business due to customer conservation caused by more efficient  
14 appliances and rising commodity costs. As the Commission is aware, National  
15 Grid does not profit from the sale of the gas commodity, but the Company is  
16 nevertheless affected by customers using less of the commodity because of the  
17 way in which rates are designed. Moreover, although National Grid does not  
18 profit from the commodity sale, it depends on the delivery of those sales volumes  
19 to obtain a significant amount of the revenue needed to operate the gas business.  
20 In an environment where energy conservation is paramount, this places the  
21 Company in the precarious position where its efforts to advance the policy

1 objectives of Rhode Island policymakers produce a negative effect for the  
2 Company's recovery of the allowed revenue requirement. Stated simply, by  
3 implementing programs to help customers to use even less gas, the Company is, at  
4 the same time, undermining its financial health. Thus, the Company is not  
5 receiving the proper economic signals in advancement of important  
6 environmental policy goals, which the Company nevertheless has embraced.

7 Given these factors, the Company strongly believes it is becoming increasingly  
8 important to "decouple" the revenues obtained from energy consumption  
9 volumes. Otherwise, the combination of (1) reduced usage per customer that has  
10 been experienced, and (2) the additional reductions that will inevitably result from  
11 the Company's investment in gas efficiency, will have a negative impact on the  
12 Company's business. Such a result would not be consistent with the  
13 environmental and customer cost reduction objectives of greater energy  
14 efficiency. Moreover, as a practical matter, it is simply not logical to ask the  
15 Company to pursue programs that ultimately will ultimately undermine its  
16 financial health, while also expecting superior performance in terms of safety and  
17 reliability. For that reason, it is imperative that this contradiction be addressed.  
18 To address this need, the Company is proposing a decoupling mechanism that will  
19 effectively remove the disincentive inherent in the current rate scheme to pursue  
20 gas efficiency programs.

1    **Q.    CAN YOU BE MORE SPECIFIC ABOUT THE REDUCTION IN USE PER**  
2           **CUSTOMER?**

3    A.    Yes. As discussed in the testimony of Mr. James D. Simpson, although the gas  
4           industry has historically experienced some degree of decline in customer  
5           consumption as a result of technological efficiency gains, in the period June 2004  
6           through December 2007, annual gas consumption by a typical residential heating  
7           customer in Rhode Island decreased by nearly 11.4 percent on average, resulting  
8           in lost revenues of approximately \$7.6 million on an annualized basis for the  
9           residential heating class alone. Similar reductions in per-customer usage have  
10          occurred in the commercial and industrial (“C&I”) sector. In fact, the weather-  
11          normalized firm throughput for the test year ending September 30, 2007 is less  
12          than the benchmark firm throughput for the year ended June 30, 2003, as  
13          established in the Company’s last rate proceeding. These declines have occurred  
14          as a result of customer-initiated conservation efforts and are beyond the control of  
15          the Company.

16   **Q.    WHAT IS THE COMPANY’S EXPECTATION IN TERMS OF THE**  
17           **MAGNITUDE OF ENERGY SAVINGS AVAILABLE AS A RESULT OF**  
18           **THE IMPLEMENTATION OF ENERGY-EFFICIENCY PROGRAMS IN**  
19           **RHODE ISLAND?**

20   A.    As I alluded to earlier, the Rhode Island legislature recently authorized the  
21          Commission to establish a formalized energy efficiency program in Rhode Island

1 to be offered to customers through National Grid. In accordance with that  
2 mandate, the Commission has approved a settlement agreement and compliance  
3 filing submitted by National Grid regarding the start-up of energy efficiency  
4 efforts in 2007 and 2008 (Order No. 19024 in Docket No. 3790). As initially  
5 devised, these programs are expected to result in annual natural gas savings of  
6 198,908 MMBtu representing only the beginning of what is possible in terms of  
7 customer conservation. The Company is convinced that there are sufficient cost-  
8 effective natural gas energy efficiency opportunities in Rhode Island to justify  
9 ramping up its program efforts in the future and expects, eventually, to submit a  
10 proposal to increase funding for its natural gas energy efficiency program efforts  
11 to the maximum amount currently allowed under the law. Significantly, these  
12 programs will have the dual impact of reducing energy consumption and resulting  
13 energy costs on individual customer basis, which is a positive in terms of benefit  
14 to customers.

15 **Q. CAN YOU ELABORATE ON WHY THE COMPANY'S ENERGY**  
16 **EFFICIENCY PROGRAMS POSE AN ADVERSE IMPACT ON SALES**  
17 **REVENUES UNDER THE CURRENT RATEMAKING PROCESS?**

18 A. Yes. In Rhode Island, National Grid is a regulated gas (and electric) company  
19 that currently recovers revenues through rates approved by the Commission using  
20 a methodology that ties the revenues to be collected to the number of units sold  
21 like any other business might do. However, most businesses are not engaged in

1           reducing the demand for their product at the same time they are trying to sell  
2           product to recover their relatively fixed costs of service. Therefore, the “flipside”  
3           of the Company’s new conservation and energy efficiency programs in Rhode  
4           Island will be reduced gas usage in each year following the setting of new rates in  
5           this proceeding. Since rates are set to recover the Company’s allowed revenue  
6           requirement over test-year billing determinants, declining usage per customer has  
7           the direct and inevitable impact of depriving the Company of revenues that have  
8           been allowed by the Commission to recover reasonable and prudently incurred  
9           costs, and are needed by the Company to operate the system on a safe and reliable  
10          basis. Consequently, the Company’s new energy efficiency programs and  
11          existing customer-initiated conservation efforts will have the combined effect of  
12          creating an insurmountable challenge for the Company in terms of attempting to  
13          avoid or prolong the need for one or more base-rate cases. This should not be the  
14          case where National Grid is deeply committed to the success of its new energy  
15          efficiency programs in Rhode Island and the ideals that the programs encompass.  
16          Customers will benefit from the Company’s proactive support of energy  
17          efficiency programs that provide valuable opportunities to customers to reduce  
18          energy usage and lower monthly bills.

1    **Q.    MOVING TO THE NEXT ITEM, WHAT IS THE COMPANY’S**  
2           **PROPOSAL FOR COST-EFFECTIVE SYSTEM UTILIZATION AND**  
3           **HOW DOES IT SERVE PUBLIC-POLICY OBJECTIVES?**

4    A.    The testimony of Mr. Sean P. Mongan discusses the Company’s proposal to  
5           achieve cost-effective system utilization through the establishment of a Gas  
6           Marketing Program that would encourage and facilitate conversions of new and  
7           existing low-use customers to gas service. Under public-utility ratemaking  
8           principles, cost-effective system utilization is beneficial to the Company and its  
9           firm customers because it allows the fixed costs of building, maintaining and  
10          operating the Rhode Island distribution system to be spread over a larger customer  
11          base. In addition, encouraging the expansion of natural gas service is consistent  
12          with national energy policy, which favors the use of natural gas as the  
13          environmentally sound alternative to other forms of energy. Lastly, although it  
14          may be counterintuitive, efforts to increase system utilization are especially  
15          important where there is a strong movement to encourage end-use conservation  
16          because the fixed costs of the system will have to be recovered over diminishing  
17          units, unless new customers are added to share in those costs (and in the  
18          Company’s conservation efforts).

19          The Company views the implementation of the Gas Marketing Program as a  
20          critical and long overdue initiative for Rhode Island. Based on the Company’s  
21          actual experience in New York, Massachusetts and New Hampshire, the Gas

1 Marketing Program is a proven "win/win" strategy for maximizing system-  
2 utilization opportunities on behalf of customers and serving environmental policy  
3 goals. Typically, there is a higher initial cost for the installation of natural gas  
4 equipment than oil replacements, particularly in the small commercial/industrial  
5 and residential market sectors. However, non-heating gas customers are *already*  
6 connected to the distribution system, and therefore, these types of customers  
7 represent a relatively low-cost opportunity to increase load if those customers can  
8 be motivated to select natural gas when considering the replacement of electric or  
9 oil heat or water-heating equipment. The Company's experience has shown that  
10 it can overcome this obstacle by finding ways to help customers fund the cost of  
11 replacement equipment and complete the installation process.

12 To that end, the key underpinning of the Gas Marketing Program is that it is  
13 designed to add customers on a cost-effective basis from a system perspective.  
14 This means that the cost of adding the customer is less than the revenue stream  
15 that is produced by the customer over a reasonable period. Since, in a ratemaking  
16 proceeding, base rates are set to recover the allowed revenue requirement over  
17 available billing determinants, successful efforts to add customer load on a cost-  
18 effective basis has the direct result of lowering the distribution price below what  
19 the rate would otherwise be, all else being equal. The testimony of Mr. Mongan  
20 describes the Company's economic analysis, which is used to determine whether  
21 customer additions will be cost-effective for the system, and explains the benefits

1 available from future load growth obtained through implementation of this  
2 program, the forecasted benefits are factored into the revenue requirement in this  
3 case.

4 For the Company, the core driver of the need for the Gas Marketing Program is  
5 the realization that system utilization will not occur at a level that is sufficient to  
6 offset reduced conservation and provide the maximum benefit for existing  
7 customers, unless the Company is able to take steps to overcome the obstacles  
8 that currently exist to discourage gas conversions, especially among low-use  
9 customers. This makes the Gas Marketing Program a natural and proactive  
10 approach for National Grid to seek to grow its customer base for the benefit of  
11 customers, especially where customers have choices in the marketplace and are  
12 aggressively solicited by unregulated purveyors of alternative energy sources.  
13 Thus, the Gas Marketing Program serves as a critical link between the Company's  
14 need to maintain sufficient funding for utility operations, to reduce the level of  
15 fixed costs recovered on a per-customer basis (all else being equal), and to  
16 support energy efficiency and conservation programs for customers, which work  
17 to reduce energy consumption on a per-customer basis.

1    **Q.    WHAT IS THE COMPANY’S PROPOSAL FOR INCREASED CAPITAL**  
2           **INVESTMENT AND HOW WILL IT SERVE PUBLIC POLICY**  
3           **OBJECTIVES?**

4    A.    The testimony of Ms. Susan L. Fleck discusses the Company’s proposal for  
5           accelerated infrastructure replacement in detail. As stated in her testimony,  
6           National Grid’s fundamental obligation is to maintain the distribution system in a  
7           manner that will provide safe and reliable service to customers and that is in  
8           compliance with applicable state and federal pipeline safety regulations.  
9           Although the level of capital investment undertaken by the Company’s  
10          predecessor (Southern Union and its predecessors) remained in basic compliance  
11          with applicable federal pipeline safety regulations, National Grid has identified  
12          that the pace of certain capital replacement programs need to be accelerated to  
13          achieve a greater level of safety and reliability. To that end, the Company is  
14          proposing to establish a discrete funding mechanism to support the accelerated  
15          replacement of bare-steel and cast-iron mains, and high-pressure, bare-steel  
16          services located inside customer premises (hereinafter referred to as "HP/IS").

17          The Company’s proposal to increase capital spending for bare steel and cast-iron  
18          replacement and the replacement of HP/IS is consistent with both the Company’s  
19          operating plan and the public interest for the simple reason that public safety is  
20          directly and negatively affected by degradations in the physical integrity of the  
21          system resulting from the relatively measured pace of historical reinforcement

1           efforts. As explained in the testimony of Ms. Susan L. Fleck, the number of leaks  
2           experienced by the Company in a year is a function of pipeline integrity. The  
3           accelerated replacement of bare steel and cast-iron mains will significantly reduce  
4           the number of leaks occurring on a year-to-year basis, which in addition to the  
5           obvious safety and reliability benefits would produce environmental benefits.

6           Therefore, among all of the capital work performed annually by the Company, the  
7           replacement of bare steel and cast-iron mains and HP/IS must be given special  
8           attention because the resulting benefit in terms of improved public safety and  
9           reliability would be significant. Accordingly, the Company is proposing to  
10          implement an accelerated program of cast-iron and bare steel main replacements  
11          and HP/IS replacement in order to raise system integrity above historical levels,  
12          which while being acceptable from a regulatory compliance and engineering  
13          perspective, would be substantially improved upon if funding were made  
14          available through a targeted mechanism. The ratemaking treatment associated  
15          with the Company's proposal is discussed in the testimony of Mr. Michael D.  
16          Laflamme, and is designed to ensure that customers pay no more and no less than  
17          the cost of the Company's actual investment.

1    **Q.    WHAT IS THE COMPANY’S PROPOSAL FOR THE TREATMENT OF**  
2           **MERGER-RELATED SYNERGIES AND HOW DOES IT FIT WITHIN**  
3           **THE COMPANY’S OPERATING PLAN, WHILE ALSO SERVING**  
4           **PUBLIC POLICY OBJECTIVES?**

5    A.    The testimony of Mr. Alan V. Feibelman and Mr. Richard J. Levin discusses the  
6           Company’s identification of merger-related synergies stemming from the National  
7           Grid-KeySpan merger, with the ratemaking treatment for merger synergies  
8           discussed in the testimony of Mr. Laflamme. As discussed in Mr. Laflamme’s  
9           testimony, the Company has quantified annual net savings resulting from the  
10          National Grid-Southern Union merger of approximately \$2.3 million (net of costs  
11          to achieve). These are synergies that actually occurred in the test year ended  
12          September 30, 2007, which is the first full 12-month period following the  
13          completion of the merger, or are known and measurable through the rate year. In  
14          accordance with Commission ratemaking precedent for merger synergies, 50  
15          percent of these synergies (or \$1.16 million annually) are reflected in the test-year  
16          cost of service.

17          In addition, the testimony of Company witnesses Feibelman and Levin (on merger  
18          synergies) and Mr. Laflamme (on the allocation of synergies to Rhode Island),  
19          quantify annual net savings resulting from the National Grid-KeySpan merger of  
20          \$4.9 million, net of the costs to achieve. These synergies did not occur during the  
21          test year, but are expected to occur going forward. Therefore, the Company has

1 reduced the test-year cost of service by an additional \$2.45 million to ensure that  
2 Rhode Island gas customers receive the benefit of a 50 percent share of those  
3 synergies. Together, these synergies reduce the cost of service by \$3.6 million  
4 annually.

5 **Q. WHAT IS THE COMPANY'S PROPOSAL FOR THE ESTABLISHMENT**  
6 **OF LOW-INCOME DISTRIBUTION RATES AND HOW DOES IT SERVE**  
7 **PUBLIC-POLICY OBJECTIVES?**

8 A. The testimony of Company witnesses Czekanski and Heintz discuss the  
9 Company's proposal for the establishment of low-income distribution rates. As  
10 discussed therein, the Company is proposing to establish a discounted distribution  
11 rate for the residential heating and non-heating classes. The proposed low-income  
12 rates would provide a 10 percent discount off of the distribution rates ultimately  
13 approved by the Commission in this proceeding. Eligibility for the Company's  
14 low-income rate would be based upon verification of a customer's eligibility for  
15 LIHEAP or its successor program. National Grid anticipates that approximately  
16 16,000 customers will benefit from the Low Income Residential Heating based on  
17 the average number of residential gas customers that received LIHEAP grants  
18 over the past two years and approximately 2,500 customers will benefit from the  
19 Low Income Non-Heating Rates

20 The establishment of low-income rates is an important objective of the Company.  
21 National Grid has a strong commitment to its customers and recognizes that the

1 changes proposed in this filing are coming at a difficult time given the economic  
2 environment. Therefore, the Company believes that there is significant value in  
3 the aggressive implementation of customer-support activities such as cost-  
4 effective system expansion to spread fixed costs over a larger customer base,  
5 offering low-income rate discounts and budgeting assistance, and establishing  
6 energy efficiency programs to help customers reduce their energy consumption.

7 **Q. ARE THERE ANY OTHER PROPOSALS THAT YOU WOULD LIKE TO**  
8 **HIGHLIGHT?**

9 A. Yes. As I stated above, the Company's proposals in this proceeding are designed  
10 to mitigate or eliminate the impact of underlying factors that will cause persistent  
11 erosion in the Company's ability to recover its allowed revenue requirement  
12 following the completion of this case, and that will not be addressed through the  
13 establishment of rates based exclusively on the Company's historical test and  
14 rate-year data. Given the magnitude of the revenue deficiency existing at this  
15 point in time, the Company is also proposing to phase-in a three-year revenue  
16 requirement, which would mitigate the initial year rate adjustment by  
17 approximately 31 percent and establish a levelized revenue requirement increase  
18 over a three-year period. The multi-year rate plan is proposed by the Company as  
19 a methodology to align the interests of customers and the Company over a longer  
20 term in the interests of rate continuity and stability. As described in the testimony  
21 of Mr. Michael D Laflamme, the three-year rate Rate Plan would provide for

1 annual rate adjustments of equal amounts in each of the three years and  
2 incorporate a full capital tracker to ensure that customers are not supporting  
3 forecasted infrastructure investments that do not materialize. In addition, the Rate  
4 Plan is designed to provide the Company with a levelized return over the three-  
5 year period, based on a forecast of the Company's cost of service in those three  
6 years. If the Company's actual cost of service is higher than anticipated, the  
7 Company would not earn its allowed return. At the same time, the three-year  
8 Rate Plan would maintain the Company's existing earnings sharing provisions to  
9 ensure that any incremental benefits derived as a result of the Company operating  
10 at cost levels lower than projected would be shared with customers. From the  
11 Company's perspective, the creation of a three-year Rate Plan to provide the  
12 revenues necessary to support the Company's efforts to provide safe and reliable  
13 service, while also mitigating the immediate rate impact on customers would be  
14 an ideal resolution of this proceeding.

15 **Q. DO YOU HAVE ANY SUMMARY COMMENTS ON THE COMPANY'S**  
16 **PROPOSALS IN THIS PROCEEDING?**

17 A. Yes. As I discussed above, the Company is requesting base-rate relief because it  
18 is currently unable to recover the cost of conducting operations on a safe and  
19 reliable basis. Moreover, the current ratemaking paradigm does not deal  
20 effectively with factors that undermine the Company's ability to recover its  
21 allowed revenue requirement over time including increasing O&M costs,

1 declining use per customer and the need to increase capital investment to  
2 accelerate the replacement of aging distribution infrastructure. Because achieving  
3 a higher level of safety, reliability and beneficial environmental impact are  
4 important objectives of the Company, its regulators and its customers, it is in the  
5 interests of both customers and the Company to put in place a rate structure to  
6 support these objectives. On a collective basis, the Company's proposals are  
7 designed to create the platform for success on the objectives of safety, reliability  
8 and beneficial environmental impact by inhibiting the revenue erosion that would  
9 otherwise occur and emphasizing accelerated capital investment, cost-effective  
10 system utilization, promotion of customer conservation and energy efficiency  
11 efforts and low-income assistance. Through these proposals, the Company hopes  
12 to achieve a level of continuity and stability that will serve the interests of  
13 customers over the long term.

14 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

15 A. Yes, it does.