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November 10, 2008

VIA HAND DELIVERY & ELECTRONIC MAIL

Luly E. Massaro, Commission Clerk
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02889

RE: *National Grid Request for Change of Gas Distribution Rates,* Docket No. 3943

Dear Ms. Massaro:

Enclosed please find an original and seven (7) copes of the Reply Brief of Rhode Island Hospital in the above-captioned proceeding. We also have submitted this filing in electronic format.

Please contact me should you have any questions concerning this matter.

Very truly yours,

Andrew O. Kaplan (dd)

Andrew O. Kaplan

cc: Service List

Enc.

1004150_1

Certificate of Service

I hereby certify that a copy of the cover letter and/or any materials accompanying this certificate were electronically submitted and mailed to the individuals listed below.

/s/ Andrew O. Kaplan
Andrew O. Kaplan

Date: November 10, 2008

National Grid (NGrid) – Request for Change in Gas Distribution Rates
Docket No. 3943 - Service List as of 9/15/08

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STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
BEFORE THE PUBLIC UTILITIES COMMISSION

NATIONAL GRID APPLICATION FOR AN INCREASE IN GAS DISTRIBUTION RATES	))))	Docket No. 3943

REPLY BRIEF OF
RHODE ISLAND HOSPITAL

I. SUMMARY

Rhode Island Hospital (the "Hospital") appreciates the opportunity to respond to those issues raised in the Initial Briefs submitted by National Grid (the "Company") and the Division of Public Utilities and Carriers (the "Division") pertaining to the development of non-firm rates and the revenue reconciliation mechanism.[1] In its Initial Brief, National Grid stresses the need to establish a pricing structure for non-firm services that is fair for all customers and concedes that the existing Value of Service ("VOS") price structure "may appear 'usurious' or unreasonable even when a cap is applied." Moreover, the Company reiterated that non-firm rates should be set at a level that allows National Grid to collect revenues that will offset the cost of the system, as is done currently. The Hospital agrees with National Grid that non-firm ratepayers should contribute to the Company's infrastructure costs and proposed a non-firm rate design that would ensure National Grid recovers significant system costs from its non-firm ratepayers.

Neither National Grid nor the Division find fault with the Hospital's proposal. Instead, the Company states its belief that a VOS price structure is the only mechanism that would ensure recovery of distribution costs. However, as demonstrated by the record evidence, the Company's

[1] In its Brief, the Division has apparently (and appropriately) abandoned Mr. Oliver's ill-conceived proposal to design non-firm rates using various benchmarks. The Division did not raise its proposal in its Brief or provide any record evidence to support Mr. Oliver's prefiled testimony. Accordingly, the Commission should reject the Division's proposed non-firm rate proposal.

premise is false. Accordingly, for the reasons detailed herein (and delineated in its Initial Brief), the Hospital respectfully requests that the Commission (1) adopt the non-firm rate proposal set forth in its Initial Brief and that of The Energy Council of Rhode Island ("TEC-RI") and (2) deny the Stipulation Regarding Reconciliation of Revenues from Firm and Non-Firm Dual-Fuel Customers ("Stipulation") and instead calculate the reconciliation mechanism based upon revenues of $1.6 million and not $2.8 million, as proposed.

II. ARGUMENTS

A. Rhode Island Hospital's Proposal For Non-Firm Rates Will Ensure That The Company Collect A Fair And Equitable Contribution To The Cost Of The Distribution System.

In its Initial Brief, National Grid implores the Commission to set non-firm rates so that the Company can collect enough revenues from non-firm ratepayers to offset the cost of its distribution system.[2] National Grid erroneously claims that the only way to ensure that enough revenues are generated by non-firm ratepayers is to establish non-firm transportation rates based upon a Value of Service ("VOS") pricing mechanism and to cap non-firm rates at 150 percent above firm rates.[3] The Company attempts to rationalize its proposal by arguing that (1) the VOS pricing framework has functioned without a problem for over 20 years[4] and (2) using cost-based rates to design non-firm rates will skew other rate classes and not guarantee National Grid's ability to recover costs of its distribution system. As detailed below, the Hospital submits that the Company's first rationalization is irrelevant to this proceeding and, as demonstrated by the record evidence, its second argument is erroneous.

Whether the VOS pricing framework has functioned well for over 20 years is arguable at best. However, the record evidence is clear that on a going forward basis, VOS pricing as

[2] National Grid Brief at 82.
[3] Id.
[4] Id. at 80

currently structured will result in rates to non-firm customers that cannot be justified on **<u>any</u>** basis. In 2008, under VOS pricing, the energy costs experienced by the Hospital and other extra large high volume customers fluctuated from $0.10/dekatherm to $2.83/dekatherm. That alone should signal the Commission that setting gas transportation rates based upon oil prices is no longer a viable pricing mechanism and certainly not an effective way to help stabilize energy prices or to mitigate the ongoing financial hardships experienced by Rhode Island's largest service and manufacturing entities during the worst economic crisis our nation has faced since the 1930s.

National Grid recognizes that its non-firm customers are "economically important entities" but states that they should not be afforded "preferential" treatment.[5] Specifically, National Grid argues that if non-firm ratepayers will not "commit to the system as firm customers, then they can maintain their non-firm status and pay a price (VOS subject to a 150% rate cap)."[6] The record evidence does not support National Grid's statement that non-firm customers have a choice to convert to firm service. Specifically, in responses to Record Requests, National Grid admits that it is incapable of providing the class of non-firm customers with firm service unless the Company improves its distribution system infrastructure at a cost of at least $9-10 million.[7] Thus, if the Commission approves National Grid's proposal and, as a result non-firm ratepayers convert to firm service, it is likely that the Company will seek to recover those costs from the non-firm customers as contributions in aid of construction, or seek additional rate increases to recover the costs necessitated to improve its infrastructure before it is capable of serving Rhode Island's largest end users. Interestingly, on one hand the Company

5 Id. at 81-82.
6 Id. at 82.
7 RR Div-5 and 6; RIH Brief at 5-6.

requests that the Commission incentivize non-firm ratepayers to commit as firm customers[8] yet, on the other hand, the Company acknowledges that if the Commission set rates that incentivize the remaining non-firm ratepayers to convert to firm service, National Grid is incapable of providing them services.[9]

The Company's second rationalization for using VOS is that designing non-firm rates based upon cost-based rates will skew other rate classes. National Grid claims that (1) the resulting rates will not represent the costs to serve firm customers and (2) the Company would not be assured of recovering the costs allocated to non-firm ratepayers for its distribution system.[10] The Hospital submits that this argument is a "red herring" and not supported by the record evidence.[11] In fact, the Hospital never suggested that National Grid design its firm rates differently or reallocate its demand distribution system costs. Rather, the Hospital has proposed using the Company's cost of service study to assist the Commission to determine a just and reasonable non-firm rate level. The Hospital submits that a legally sound non-firm rate is one that is based on a fixed discount off the firm rate that the Company's Commercial and Industrial ("C&I") customers would be eligible to receive. The November 5, 2008 cost of service study submitted by National Grid is similar to its previous iterations and reveals that if the Company generates revenues of $1.8 million from non-firm ratepayers, these revenues would represent a substantial contribution to the Company's cost to maintain its existing distribution system and

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8 National Grid Brief at 82.

9 Moreover, the Company's claim that its non-firm ratepayers are not committed to using natural gas fails to recognize that the State's largest service and manufacturing entities have incurred, and continue to incur, substantial costs to maintain the capacity to burn natural gas rather than oil, for both economic and environmental reasons.

10 National Grid Brief at 87.

11 The Division has offered nothing substantive with respect to using the Company's cost of service in the development of non-firm rates. In its Brief, the Division focuses on relatively minor issues. By focusing on the minutia, the Division failed to recognize that the Company has allocated identical demand distribution system costs to non-firm and firm ratepayers, even though National Grid offers a lower level of service to its interruptible customers.

would continue to be credited to firm rates.[12] As proposed therefore, all non-firm revenues would be credited to firm ratepayers, just as is done currently. And, importantly, all of this is accomplished without using an outdated VOS pricing mechanism or mandating that non-firm rates be arbitrarily capped at 150% above firm rates. Finally, contrary to the Company's claim, the Hospital's proposal would not affect how firm rates are designed.[13]

B. The Commission Should Reject The Proposed Stipulation To Reconcile Revenues Of $2.8 Million And Instead Allow Reconciliation Of $1.6 Million.

The Hospital, through its expert witness Mr. DeMetro, revealed the potential windfall to the Company, to the detriment of firm customers, if the Company's non-firm rate proposal was adopted by the Commission. To ensure that the Company does not receive a windfall associated with the migration of customers between firm and non-firm service, the Company and the Division have proposed a reconciliation mechanism which they claim will assure revenue neutrality for firm customers and the Company. However, the mechanism, which presumes migration will reverse itself for certain customers, is flawed and incorporates a highly uncertain volumes estimate in its calculation.

The Hospital strongly opposes the assumed revenue increase of the threshold level embedded in firm rates to $2.8 million and submits that there is no need to change the current $1.6 million credit to the firm cost of service currently embedded in rates. The Hospital emphasizes that whether its proposal to continue the $1.6 million base rate credit is approved or

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12 Over the most recent 12-month period, non-firm customers have consumed more volumes of natural gas than are necessary to generate revenues of $1.8 million. Without incentive to convert to firm service, the non-firm ratepayers will likely continue to use the historical level of natural gas and, as such, the Hospital's proposal will generate revenues significantly more than $1.8 million.

13 Should the Commission decide to maintain VOS pricing, the Hospital recommends setting non-firm rates at a smaller discount off of firm rates and establish that as the rate cap. Under this scenario, the VOS pricing mechanism is maintained and the Company could flex the non-firm between the minimum rate and the rate cap.

whether the Company's proposal to increase it to $2.8 million is approved, there will be no difference in the net impact on firm customers.

Currently, only $1.6 million of revenues associated with non-firm customers are credited to firm rates and any non-form revenue above that threshold is credited to firm customers through the DAC. If non-firm revenue falls below the $1.6 million level, the deficiency is surcharged through the DAC.

In its rate case filing, the Company included $1.2 million in its firm C&I billing determinants that represent the migration of non-firm customer to firm service. The Company's proposal is to leave those billing determinants in its firm rates as if none of those customers will move back to non-firm service and raise the threshold before it begins crediting revenues to firm rates to $2.8 million.

Consequently, if revenues associates with the original non-firm customer class (current non-firm and non-firm taking firm service) fall below $2.8 million, then the Company would surcharge the deficiency through the DAC. With this mechanism, the Company bears no financial risk of customers migrating between firm and non-firm service. The Hospital has no objection to eliminating the Company's risk with respect to non-firm revenues.

By increasing the threshold to $2.8 million, however, the Company (with the consent of the Division) is attempting to induce the Commission into accepting their estimate of the revenues that should be collected from non-firm customers. If the Commission does not accept the Company's proposal to cap non-firm rates at 150% of firm rates, then settlement revenue assumption could easily result in a continuing surcharge to firm ratepayers and mask the true rate that is being charged to firm customers.

To avoid this problem, the Hospital proposes a similar reconciliation mechanism but that does not change the credit embedded in firm rates. National Grid should remove the additional $1.2 million in revenues assumed in developing firm billing determinants and provide it as a credit to the DAC coincident with the new rates taking effect. This would preserve the existing revenue offset used in the initial rate filing and reflect the proper level of firm rates. The Company would then track the revenues collected from original class of non-firm customers and credit any revenues above $1.6 million through the DAC. With this change, the net difference of the impact on firm customers of this proposal from the Company's mechanism is zero. Firm customers will receive the same level of credit as that proposed by the Company and the Company bears no additional risk under this mechanism than in the one it proposed.

By directing National Grid to remove the $1.2 million in firm billing determinants and provide it as a credit to the DAC (with true-ups) coincident with the new rates taking effect, existing revenue offsets used in the initial rate filing would be preserved and additional credits to firm rates through the DAC would likely continue, regardless of how the Commission decides the non-firm rate issue.

III. CONCLUSION

For the reasons stated herein, in the Hospital's Initial Brief and as demonstrated by the record evidence, the proposal to establish non-firm rates based on a discount off of firm rates will ensure that the Commission has designed just and reasonable rates that allow the Company to recover its distribution system costs, forego the imminent need for further rate increases and help to stabilize energy costs for manufacturing and service entities. Accordingly, the Commission is respectfully requested to set the Company's non-firm rates at a 35-40 percent discount off the applicable firm rates and allow the Company to recover $1.8 million in distribution system costs. Lastly, the Hospital respectfully requests that the Commission reject the Stipulation and instead, reconcile rates based upon $1.6 million consistent with the revenue requirement calculations presented in the Company's initial filing.

Respectfully submitted,

RHODE ISLAND HOSPITAL

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