BEFORE THE

STATE OF RHODE ISLAND
AND PROVIDENCE PLANTATIONS

PUBLIC UTILITIES COMMISSION

In Re: NATIONAL GRID RHODE ISLAND GAS	)	**Docket No. 3943**
	)	**Request for a Change of Gas Distribution Rates**

DIRECT TESTIMONY

of

JOHN FARLEY

Submitted on Behalf of The Energy Council of Rhode Island (TEC-RI)

July 25, 2008

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INTRODUCTION

Q. Please identify yourself.

A. My name is John Farley. I am the Executive Director of The Energy Council of Rhode Island (TEC-RI), One Richmond Square, Suite 340D, Providence, RI 02906. I have been the TEC-RI Executive Director since July 2004.

Q. Please identify TEC-RI.

A. TEC-RI is a non-profit energy consortium made up of many of the largest commercial and industrial users of energy in Rhode Island. TEC-RI's objective is to lower the cost of energy for Rhode Island businesses while preserving environmental quality and adequate supply. A list of the businesses and other organizations that are members of TEC-RI is attached hereto as Exhibit JF-1.

a. Qualifications

Q. What is your work background?

A. I am currently the President of John Farley Consulting, an independent energy consulting firm specializing in the retail energy business. My practice focuses on demand-side management, utility rates, energy efficiency, performance contracting, cost-effectiveness, and measurement & verification. I have twenty-four (24) years of professional experience in the energy field. A native Rhode Islander, I have completed demand-side management projects to benefit customers in over 30 states

and several foreign countries. I have held senior technical, executive, and sales positions with several leading firms and organizations spanning government, utility, consulting, energy services, and end user customer perspectives.

Before forming my own company, I served as Vice President of Sales and Marketing for EPS Solutions, an information technology company serving the utility industry. Prior to that, I was the Manager of Information Services for TASC/LODESTAR, where my duties included building and managing an information service in conjunction with EPRI to provide critical data to utilities for DSM planning and impact evaluation. Prior to that, I served as Senior Analyst for seven years at COM/Energy, a combination gas and electric utility that has since merged into NSTAR. At COM/Energy, I led a team of 6 staff in conducting demand side management (DSM) impact and process evaluations, as well as DSM planning and cost-effectiveness. My career began as a technical advisor to the RI Governor's Energy Office managing projects with small commercial energy auditing, renewable energy, and other energy efficiency applications.

Q. What is your educational background?

A. I have a Bachelor of Science degree in Physics with highest honors from Providence College.

b. Purpose

Q. What is the purpose of this testimony?

A. The purpose of my testimony is to identify the concerns that the Company's filing in this docket has raised for TEC-RI members, large users of natural gas, and ratepayers generally, and to request that the Commission take certain actions to remedy these concerns.

c. Summary of Testimony

Q. Please provide a summary of the issues addressed in your testimony.

A. In my testimony, I address the following five issues: (1) the Non-firm tariff; (2) Revenue Decoupling; (3) the Distribution Adjustment Charge (DAC); (4) the proposed Low Income Discount; and (5) the number of Gas Cost Recovery (GCR) classes.

Q. Please describe the remedies you are requesting from the Commission.

A. I will describe the remedies we are requesting for each issue we raise;

(1) With respect to the Non-firm tariff, we are asking the Commission to order the Company (a) to comply with the Commission's directive in RIPUC docket No. 3887, specifically to file a cost of service based rate design for non-firm customers;

(b) to set non-firm rates lower than firm rates; (c) to establish interruption and restoration rules in the tariff; and (d) to put the proposal to eliminate the non-firm sales tariff on hold pending an investigation.

(2) With respect to Revenue Decoupling, we are asking the Commission not to approve the Company's proposal for revenue decoupling.

(3) With respect to the Distribution Adjustment Charge (DAC), we are asking the Commission to change the way adjustment dollars are allocated to rate classes from a volumetric approach to a cost of service approach.

(4) With respect to the proposed Low Income Discount, we are asking the Commission to require the Company stockholders to contribute 50% of the costs of the discount, and to allocate the remaining costs among customer classes according to their revenues rather than according to their dekatherm usage.

(5) With respect to the Gas Cost Recovery, we are asking the Commission to order the company to keep the number of Gas Cost Recovery classes where they are today, namely at six classes.

I. NON-FIRM TARIFF ISSUES

Q. Turning to the first issue, please give an overview of TEC-RI's position with respect to the Company's non-firm tariff proposal.

A. TEC-RI maintains that the Company's proposed non-firm service offering suffers from several deficiencies.

First, the Company did not comply with the instructions of the Commission in docket 3887 to design a cost-of-service based rate.

Second, the Company's proposal to preserve its value of service rate makes no sense in the current environment where natural gas prices are much lower than oil prices. The value of gas distribution services cannot be measured by comparing the price of the gas commodity to the price of the oil commodity, because these are fundamentally different services. Also, under the value of service approach, the Company has too much discretion in determining prices. What's more, gas distribution prices change from month to month in an unpredictable manner, making it very difficult for non-firm customers to make reasoned decisions.

TEC-RI has a straightforward recommendation to remedy the problems with the Company's non-firm proposal.

First, the Company must be required to file a cost of service based rate design for non-firm customers.

Second, since non-firm customers receive a lower quality of service than firm customers, the rate for non-firm customers should be lower than the rate for the corresponding firm customer.

Third, the Commission should require the Company to file fully transparent rules that the Company must follow in making decisions to interrupt and restore service.

Finally, the Company's proposal to eliminate the non-firm sales tariff should be put on hold pending an investigation of any harm that would come to customers currently being served on that tariff.

Q. Please explain why it is your view that the Company has not complied with the instructions of the Commission to design a cost-of-service based rate for non-firm customers.

A. In RIPUC docket No. 3887, titled SilentSherpa Energy Consulting & Professional Services, Inc. – Petition to Remedy National Grid Non-Firm Sales Service Rate RIPUC Natural Gas No. 101, the Commission issued the following Order to National Grid:

"In its next general rate case, NGrid shall file with the Commission as part of its fully allocated cost of service study, and in addition to its value of service based non-firm rates, an alternative cost of service based rate design for non-firm service customers."

TEC-RI was unable to locate the required alternative cost of service based rate design for non-firm service customers anywhere in the Company's filing.

The Company's Cost of Service study (COSS) witness was Mr. David A. Heintz of Concentric Energy Advisors, Inc. After examining his testimony, we were unable to find this cost of service based rate for non-firm service customers. It was a surprise to review the list of customer rate classes evaluated in the COSS (page 8 of Mr. Heintz's testimony, lines 8 through 15) and not find the non-firm class listed, especially when the Company's contract with Concentric specifically provides that :

"...for this project, CEA will develop cost-based non-firm rates, to comply with the RIPUC's decision in Docket No 3887..." (Company response to TEC-RI 1-23, Attachment A, p.3)

Mr. Peter Czekanski is the Company's witness for proposed tariff changes. Mr. Czekanski's testimony revealed that the Company did file a proposal for its value of service based non-firm rates, but did not file a second alternative cost of service based rate design for non-firm service customers.

The Company claims that it complied with the Commission's directive by relying on the cost of service based rate established for firm service customers to establish the proposed cap for non-firm service (Czekanski testimony, page 20, lines 4-6). However, this is plainly inadequate and not responsive to the Commission's directive, for the following reasons:

1. It relies on the cost of service for one class as a proxy for a class with fundamentally different load characteristics.

2. It relies on low load factor rate classes to represent non-firm classes that include both low load factor and high load factor customers. (see Company response to Division data request 6-26.)

3. Since non-firm customers differ from firm customers in the fact that they give up certain rights and receive a lower quality of service (meaning they must interrupt service at the Company's convenience to improve reliability for the firm customers), one would expect that the resulting "cost of service" based rate for the non-firm customers would be LOWER than the rate for the corresponding firm customers. However, the cost of service for the firm customers was used to produce a cap that is 50% HIGHER for non-firm customers than the corresponding rate for firm customers.

4. In its value of service rate design, the Company employs an arbitrary break point of 25,000 therms that results in caps differing by over 2:1. ($0.4279 per therm versus $0.1701 per therm, See Czekanski testimony page 19 lines 16-19.) However, the Company does not give any cost based justification for this break point. (See Company response to Division data request 6-27).

In short, then, the Company's value based rate design bears little if any resemblance whatsoever to a true cost of service based rate design for non-firm service customers.

Q. Why is it that the Company's proposal to preserve its value of service rate does not make sense in the current fuel price environment?

A. The value-based approach to pricing non-firm gas services might have made sense when gas prices were higher or equal to oil prices, but makes no sense when gas prices are much lower than oil prices.

When oil was consistently cheaper than natural gas, the value-based rate was a way to make natural gas sales at a price that was attractive to the non-firm customer. By reducing the price for gas distribution in return for an iron-clad right to interrupt service whenever necessary, the utility could generate additional revenues to contribute to revenue requirements and offer a competitive price for the service.

However, the value-based pricing method breaks down in a period when oil prices are consistently higher than natural gas prices. Now, the same formula results in an untenable situation whereby non-firm customers, who give up rights on the system, pay more for gas distribution services than do the firm customers who retain all rights on the system.

The value-based approach was never intended to allow this perverse pricing of distribution services to occur.

The argument that non-firm customers can simply switch to firm rates is groundless. For one thing, the Company's own data responses prove that the non-firm rate is necessary. The Company continues to interrupt non-firm customers in the winter. In addition, there are portions of the distribution system where non-firm customers are interrupted for the entire winter, and there are also cases where the Company is unable to offer firm service to customers who are currently non-firm customers.

But there is a more fundamental principle at stake here. The function of the distribution utility is to provide the distribution services that customers value, at a price that is just, reasonable, and non-discriminatory. The non-firm service provides value for the non-firm customer when it is priced correctly, i.e., at a discount to firm service, because it accurately matches the customer's reliability requirements to

the price that the customer pays for service. The same non-firm service also provides value to the rest of the ratepayers because it increases the reliability of the system while generating appropriate additional revenue to support that system.

It is striking, in fact, that the Company would take steps to discourage use of the non-firm tariff in the same filing where it is requesting new and more favorable rate treatment in order to encourage demand-side management! The non-firm tariff is an excellent demand-side management program that reduces use when that use imposes the highest costs on the system.

Q. You also take issue with using commodity prices to price distribution service. Please elaborate.

A. The value of gas distribution services cannot be measured by comparing the price of the gas commodity to the price of the oil commodity. Commodity services are fundamentally different from distribution services, and so one cannot be used reliably to determine the value of the other.

The use of the value based pricing was a marriage of convenience when oil prices where much lower than gas prices, for the practical reason that it produced results that worked well. However, the weakness of the approach became tangible when the relationship between gas prices and oil prices fundamentally changed. Commodity services are different from distribution services. The Company

acknowledges this in their own filing, since they propose to continue non-firm distribution services while discontinuing non-firm commodity sales service.

Q. Another shortcoming has to do with the discretion the Company has to set the price. How does that work, and why is that bad?

A. Under the value of service approach, the Company has too much discretion in determining what prices will be from month to month. As a result, there is always the potential for pricing outcomes that are arbitrary or that otherwise distort the market.

Under the value of service approach, there are two pieces of information that drive the non-firm gas distribution price from month to month. The first is the price of the natural gas commodity, and the second is the price of the alternative fuel (usually oil). Fuel commodity prices are notoriously volatile. Each month, the Company prepares its own estimate of Marginal Gas Cost using an internal method which is not specified in the tariff, and therefore not easily replicable by the customer or other parties besides the Company. There are also multiple paths to arriving at the alternative fuel price.

Q. The Company also proposes to re-introduce the Flexible Firm Service. Is this appropriate and helpful?

A. No, not as proposed. The Company proposes re-introducing the Flexible Firm Service, a firm transportation service based on negotiated individual service agreements with Commercial and Industrial customers that have dual fuel capability, are currently non-firm service customers, and have annual usage equal to or greater than 150,000 therms.

It is not clear why this offering would be limited to those customers who are currently non-firm service customers. Beyond that, however, this service gives too much discretion to the Company with respect to price and terms. The customer is at a major disadvantage in any negotiation with the Company because the customer lacks the transparent, consistent benchmarks for prices and costs that the customer needs to use in determining a fair price. Customers on Flexible Firm Service would share certain characteristics of a non-firm customer and certain characteristics of a firm customer. But the non-firm price varies based on unknown future prices for oil and gas. How does the customer decide whether or not a particular contract is a fair deal or not? The only way is if there is a cost of service based rate for both full non-firm and firm service, and the customers knows what the rules for interruption are going to be if he selects full non-firm service. To illustrate: the customer knows that the fully non-firm rate for distribution is 80 cents a dekatherm, and the firm rate equates to $1.60 a dekatherm. Further, under typical conditions, he expects to be interrupted for the equivalent of 10 days during the winter if he chooses the fully non-firm rate. He is negotiating with the Company to be interrupted on

average 5 days each winter. He has a solid basis for figuring out a fair price for that contract. But to repeat, the keys to making this work are (1) a cost of service based non-firm rate that does not vary every month, and (2) clear rules for interruptions spelled out in the tariff.

Q. Please provide your concluding remarks on the problems you see with the Company's non-firm service proposal.

A. The fact that the price for gas distribution services changes every month in an unpredictable manner impedes the functioning of an efficient, competitive market for fuels.

The resulting prices may induce buying behavior which is not in keeping with sound market fundamentals. It can also result in gas distribution prices that diverge wildly from month to month, and from customer to customer. This unnecessary price instability has nothing to do with the underlying service – namely gas distribution - , and stems solely from the pricing mechanism. Therefore, the price instability should not be tolerated; it should be eliminated. This is easily done by simply changing the pricing approach for non-firm services to a cost-based rate that does not fluctuate from month to month according to the volatile fuel commodity markets.

Q. Please introduce TEC-RI's proposed remedy to address the deficiencies in the Company's non-firm offer.

A. Certainly. First, the Company must be directed to comply with the direct order from the Commission in RIPUC docket No. 3887. The Company should be required to file a cost of service based rate design for non-firm customers. The Company's response to Division data request 5-53 can serve as a starting point for the design of the cost of service based rate or rates for non-firm service.

Q. Are there any guidelines for how this cost of service based rate should be structured?

A. Yes. Since non-firm customers receive a lower quality of distribution service than firm customers do, the resulting rate for non-firm customers should have a similar structure as the corresponding firm tariff but represent an appropriate discount relative to that firm rate.

The fact that the non-firm customer receives a lower quality of service is embodied in the following text taking from the Company's tariff (Section 6, Schedule A, Sheet 1):

> "The customer agrees to discontinue service, when in the sole discretion of the Company, such discontinuance is necessary in order to continue to serve the needs of firm customers at such time."

Non-firm service should always be priced at a discount to firm service, because the non-firm customer gives up certain rights and service levels that the firm customer enjoys. The Company's proposed non-firm offering violates this principle whenever oil prices are substantially higher than gas prices.

Q. What other changes are needed in the Non-firm tariff?

A. The Commission should require the Company to establish fully transparent rules in the tariff that the Company must follow with respect to decisions to interrupt service and restore service. These rules should match the level of service interruption that is embedded into the load patterns which drive the cost of service base rate.

An obvious way to establish these transparent rules would be to specify the forecasted low temperatures below which the customer will be interrupted, and above which the customer will be restored.

If there are several levels of service contemplated, then there should be several options in the rate. For example, non-firm customers who will be required to be interrupted for the entire winter season are receiving a lower quality service than those who could only be interrupted on the coldest 3-5 days. Therefore the former should receive a higher discount (pay a lower price) than the latter.

These recommendations will achieve three vital ratemaking objectives: fairness, transparency, and predictability. All three will encourage sound decisions on the part of customers as they manage their energy requirements.

Q. Finally, the Company is proposing to eliminate the non-firm sales tariff. Do you have any concerns about that?

A. Yes. The proposal by the Company to eliminate the non-firm sales tariff should be put on hold by the Commission pending an investigation of the harm that will come to customers currently being served on that tariff.

A review of the Company's responses to Division data requests DIV 5-3 and DIV 5-4 reveals that there are a significant number of non-firm sales customers, and further that some are located in system-constrained areas. The Company has not indicated that it has contacted these customers to determine their needs. It may be the case that certain of these customers are unable to be served by marketers. In addition, the Company may not be able to serve certain of these customers on a firm basis. The Company should be required to contact these customers, determine their needs, and provide a report of its findings to the Commission, the Division, and the other parties to this docket. Pending the nature of those findings, the Commission can then rule on the whether or not to eliminate the non-firm sales tariff.

II. REVENUE DECOUPLING

Q. Please provide an overview of revenue decoupling.

A. Revenue decoupling is a significant departure from traditional cost-of-service principles, which historically have provided utilities with only the opportunity to earn a fair return.

Revenue decoupling seeks to guarantee actual revenues at the level of authorized revenues. In fact, it goes beyond this. By guaranteeing a fixed level of revenues per customer at the level needed to meet its revenue requirements, this decoupling method generates revenues higher than needed to meet revenue requirements whenever the customer count increases beyond that established in the latest rate case.

TEC-RI is not aware of any provision in the regulatory compact for Rhode Island utilities that grants the right to the utility to receive a guaranteed amount of revenue for each customer it has.

Under full revenue decoupling, as we have here in the Company's proposal, the utility becomes indifferent to any driver of sales volume, whether this be changing economic conditions, weather, conservation, or new technology.

TEC-RI is a big supporter of energy efficiency. TEC-RI members are leaders in adopting and investing in energy efficiency measures to reduce costs and improve competitiveness.

Nevertheless, TEC-RI opposes the Company's decoupling proposal. It would distort the rate-setting process, set the stage for unintended consequences, produce inequitable outcomes, and do so without being a particularly effective way to promote energy efficiency.

The Company's proposed decoupling mechanism shifts risk from the Company to the ratepayer, but does not compensate the ratepayer in any way for assuming these new risks. The major risk is volume risk as a result of energy conservation or lower levels of economic activity.

The Company's decoupling proposal shifts significant business risk from shareholders to ratepayers, with vague and uncertain benefits to ratepayers.

While decoupling may align the interests of the utility with the public policy of encouraging energy conservation, decoupling removes motivation for the utility to be concerned about the state's economic health. The overall economic health of Rhode Island is, arguably, as important as or even more important than the level of utility involvement with energy efficiency.

Q. Isn't decoupling simply an attempt to increase rates without a rate case?

A. Yes. Decoupling eliminates regulatory lag, the feature of ratemaking whereby, over time, changes to costs and revenues impact the utility's margin until it becomes necessary to file a rate case. Rate cases are the most effective tool that regulators have to, well, regulate the utility. While it is understandable that the utility would want to avoid oversight of its operations and scrutiny of its books, rate cases serve a vital purpose. Rate cases are an important safeguard to the interests of the ratepayers, and they promote the effective functioning of regulation.

Q. The stated purpose for Decoupling is to encourage the Company to increase its efforts in gas conservation. Is there any evidence that this will be the effect of decoupling?

A. No, not really. For one thing, most of the reductions in use per customer that the Company says motivated it to propose decoupling were realized before the Company began its own energy efficiency program. Also, there is no new Company commitment to energy efficiency in this filing; to the contrary, the filing includes a proposed program to increase the use of natural gas in the winter.

The effective start date for the Company's gas energy efficiency programs was July 1, 2007, according to the Company's response to Wiley Center data request 2-16.

In the years prior to that, the Company states that its only direct involvement with energy efficiency was a modest contribution to the State Energy Office to provide energy efficiency services to low-income customers.

Mr. James D. Simpson of Concentric Energy Advisors is the Company's decoupling witness. Mr. Simpson devotes a substantial section of his testimony to documenting reductions in gas usage by National Grid customers in recent years. He uses a measure called normalized use per customer (NUPC) to do so. His testimony includes a set of attachments that graphically show the trend in NUPC by rate class over the period June 2004 through December 2007 for the Residential Heat, Commercial & Industrial ("C&I") Small, and C&I Medium classes (Attachments NG-JDS-4 through NG-JDS-6). In response to a TEC-RI data request, the Company also provided these graphs for the C&I Large and Extra Large classes.

These graphs show that the majority of the reduction in NUPC occurred prior to July 1, 2007, the start date for the Company's efficiency programs. Thus, the reductions in use per customer that have motivated the Company to propose revenue decoupling cannot reasonably be attributed to the Company's own energy efficiency programs.

It appears then that the problem the Company would like to fix with revenue decoupling is basically decoupled from the Company's own energy efficiency efforts!

According to the testimony of another Company witness, Mr. Nickolas Stavropoulos, the primary reason for the Company's revenue decoupling proposal is to "advance the goal of achieving greater energy efficiency in the State of Rhode Island" (page 13, lines 17-18 of the pre-filed direct testimony of Mr. Stavropoulos).

Yet, the Company is not proposing to expand any gas efficiency programs in their filing (see for example the Company's response to Wiley Center data request 2-17). Instead, they are proposing to introduce a new gas marketing program. Gas efficiency programs are designed to reduce gas consumption, particularly in the winter heating season. On the other hand, the Company's proposed gas marketing program is designed in increase gas consumption in the winter heating season.

The Company's own filing shows that decoupling does not necessarily advance the policy objective of more energy efficiency, and its purpose is not primarily to mitigate the impacts of its own energy efficiency programs.

A more likely explanation for the request to decouple is this: the Company recognizes that the environment it operates in has changed. High energy prices generally are driving customers to use less energy. On the other hand, in Rhode

Island, gas competes in several markets with oil, and gas is priced favorably compared with oil.

This environment may very well produce more gas customers, but lower use per customer. By insulating itself from the negative impacts of declining use per customer, and reaping the benefits of increasing numbers of customers, the Company gets to have it both ways.

Decoupling primarily serves the Company's goal of improving its earnings, not so much the policy goal of increasing energy efficiency in Rhode Island.

Q. Does the Company's decoupling proposal go beyond what is needed to protect the utility from reductions in consumption caused by customer demand-side management actions?

A. Yes, it goes beyond what is needed.

The proposal would protect the Company from reductions in use per customer for any reason whatsoever, be it price elasticity effects, general economic conditions, or technology innovation.

It is one thing to develop ratemaking mechanisms that compensate utilities for reductions caused by the utility's own efforts to meet public policy objectives. It is a very different thing to give the utility an automatic adjustment mechanism that protects them from reductions in revenue per customer regardless of the cause.

The price elasticity effect is particularly important. The Company continues to procure gas commodity for the majority of the gas it distributes in Rhode Island. Without decoupling, the Company has added incentive to do everything it can to keep the commodity price as low as possible, since increases in commodity price lead to reductions in gas use, and reductions in gas use lead to lower revenues and earnings for the Company. With decoupling, that incentive goes away.

Further, there is a tacit assumption that the reason why revenues in a class would decline is solely the result of conservation, or more broadly, reductions in the volumes of gas used. This may not at all be the case in the future, particularly in the commercial and industrial classes, where the Company's new rate design shifts revenues to the customer and demand charges. Customers in a rate class may be reducing their bills because they are correctly responding to price signals by better managing their peak day draws. Should customers be penalized because they have responded appropriately to Commission-approved price signals?

Ratepayers should not be required to protect distribution utilities for lost profits or financial harm caused by any factor that would reduce usage of the product they distribute. It is a feature of financial investments that all capital, including utility capital, is exposed to the risk that the future is uncertain and that demand for products can change.

The utility should not be entitled to raise its rates without at a minimum bearing the burden of proof that the revenue reductions were a direct result of compliance with law or regulatory policy.

Q. Please comment on the Company's particular "Revenue per Customer" methodology.

A. The Company's "Revenue per Customer" methodology has the drawback that it fails to include necessary protections for the ratepayer.

There is no recognition that there may be adverse outcomes for ratepayers. As a result, there are no provisions in this proposal that would serve to ameliorate those adverse outcomes.

Other states, for example, have placed limits on the size of the adjustment that can be made in any one year.

These adjustments can be quite high. Maine's experience in the early 1990's with Central Maine Power was that the decoupling adjustment resulted in large, unexpected increases in prices.

One TEC-RI data request (TEC-RI 1-7) asked the Company to show what the adjustments to distribution rates would have been if this decoupling mechanism had been in effect starting in period beginning winter 2003-2004. Based on the Company's response, it turns out that had decoupling been in effect for the 12 months ended June 2008, ratepayers would have paid an additional $11,618,128 to the Company; for the past four years, the payments would have totaled over $34 million!

Now, certainly the argument can be made that the Company was earning less than its allowed rate of return. But $11 million in any one year, or $34 million over four years, is a lot of money, and it shows that before making a change like this one, it needs to be carefully vetted. The payments would have been positive in each year (meaning in no year would there have been a refund to customers), putting claims that this can work to the advantage of the ratepayer in the proper perspective. It might theoretically work to the advantage of the ratepayer from time to time, but it would not have in the past several years, and given trends in the gas market (price hikes and efficiency gains) it probably won't in the future.

There are some indications that this proposal has not received the scrutiny it requires. For one thing, the Company was not able to provide key information that one would need in order to assess the likely impact of the decoupling mechanism on customers. These include data on heterogeneity within rate classes, as well as migration patterns and their impact on revenue per customer.

Heterogeneity refers to level of variation that exists in revenue or in usage across customers in a rate class. To use a simple illustration, there could be two rate classes, each with three customers, having the same average revenue per customer of $100. Class A individual customer revenues are $99, $100, $101. Class B individual customer revenues are $1, $100, $199. Class B is more heterogeneous than Class A. Remove the low or the high customer from Class A, and the average changes very little. Remove the low or the high customer from Class B, and the average changes a lot!

The Company does acknowledge generally that heterogeneity in the large commercial and industrial rate classes can be a problem, especially since there are small numbers of customers in these classes. (James D. Simpson Page 6 of 31, lines 5 through 7). However, the Company does not acknowledge that this factor, which caused the Company to exclude new C&I customers from decoupling (for

the negative impact this has on the Company) can work to hurt all customers in these rate classes as well.

Migration back and forth between firm and non-firm can produce additional swings in revenue per customer in the Large and Extra Large classes, and thereby produce inequitable outcomes. For example: pro forma adjustments the Company made to account for customers switching from non-firm to firm service in just a 4 month period changed the use per customer averages substantially for the Extra Large Low Load and High Load Classes, as the following tables show:

Rate Year:

Rate class	Annual usage [1] (Dt)	# of customers[2]	Use per customer (Dt/cust)	
X Large Low	1,206,657	38	31,754	
X Large High	4,947,980	74	66,865	

[1] Rate year usages are from Attachment NG-PCC-2, page 1 of 2, column (f)
[2] Customer counts are from Attachment NG-PCC-7

Customers who switched from Non-firm to Firm in the period October 2007 – January 2008[3]:

Rate class	Annual usage (Dt)	# of customers	Use per customer (Dt/cust)	
X Large Low	405,187	5	81,037	
X Large High	925,608	7	132,230	

Rate year look with switching customers removed:

Rate class	Annual usage (Dt)	# of customers	Use per customer (Dt/cust)	% impact from switching customers:
X Large Low	801,470	33	24,287	**31%**
X Large High	4,022,372	67	60,035	**11%**

Thus, the Company's own filing documents show that customers switching from non-firm to firm service over a short period of time (4 months) changed the usage per customer averages for these two classes by 31% and 11% respectively. This

[3] Annual usage and customer counts are from Workpaper PCC-4 in Vol 5 Page 196.

fact alone should give pause to any ideas of applying use per customer or revenue per customer targets to the Large or Extra Large rate classes.

Q. Would decoupling increase the non-participant penalty that is produced by utility energy efficiency programs?

A. Yes. This is a result of how the costs of decoupling are distributed among customers in a rate class. Customers who participate in the efficiency program see their usage decline. All else being equal, this brings the revenue per customer for the class down. This increases the decoupling adjustment that all customers in the class must pay. In addition, the customer that "caused" the adjustment pays less of it as a result of participating in the program, for the simple reason that the adjustment is collected using a per dekatherm charge – and the participant lowered their dekatherm use. This effect is more pronounced in rate classes with small numbers of customers.

The Company's energy efficiency program takes money from all ratepayers to pay for the energy efficiency services for a few ratepayers in a given year. The relatively few ratepayers who participate in the program in any one year receive all or nearly all of the direct benefit of the program, while the remaining ratepayers bear nearly all of the costs of the program. Decoupling further exacerbates the problem.

The non-participants may be customers who simply choose not participate, but they may also be customers who cannot participate in the energy efficiency program for valid reasons. Examples might be low income customers who receive their efficiency services from other sources, under-served sectors that the utility has a hard time reaching, and early adopters who voluntarily paid for energy efficiency measures themselves already.

Decoupling encourages the following mind set on the part of the alert customer: by all means, do as much energy efficiency as you can in your own facilities, since that brings your bill down. But, whatever you do, don't support programs where you pay for somebody else's efficiency, because you will pay twice: once when you pay the surcharge for the program, and again when you get the bill from decoupling.

Decoupling also erodes the incentive for customers to conserve energy. Customers who do a great job saving energy will see their distribution rates increase as a result. At the end of the day, it is customers who create energy savings, not utilities. Improving the utility's bottom line while penalizing the customers who produce the savings in the first place does not seem like a winning strategy for fostering energy efficiency.

Q. You have referred a couple of times to the unique problems that revenue per customer targets create for large Commercial and Industrial customers.

Given that, what is the best practice for these classes when it comes to decoupling, if it is adopted?

A. The evidence points to the fact that best practice in decoupling, if it is adopted despite its problems, is to exclude the large use, small customer count rate classes completely from revenue per customer decoupling. For National Grid Rhode Island, these would be the Large and Extra Large rate classes.

Any examination of decoupling must give particular care to the impact that any such mechanism would have on large commercial and industrial customers.

The Company's proposed decoupling mechanism adjusts revenues based on a revenue per customer benchmark. As the Company states, residential and small commercial classes have less diverse usage patterns than those exhibited by the high usage large commercial and industrial rate classes (Large and Extra Large).

The Large and Extra Large rate classes have a relatively small number of customers in each, and those customers are relatively heterogeneous, meaning that their loads and revenues are highly diverse.

Under the Company's revenue per customer decoupling proposal, customers in such a small count, heterogeneous rate class can be unduly impacted by events such as customer migration or significant reductions in load due to aggressive

implementation of demand resources by other customers in the same rate class. For example, revenues could drop dramatically when an extremely large commercial customer migrates from firm to non-firm service, and this would result in the remaining customers in that rate class seeing a disproportionate increase in rates as a result of the decoupling true-up.

In response to a TEC-RI data request, the company's witness revealed that 22 out of the 25 LDC listed in attachment NG-JDS-3 use revenue per customer or use per customer decoupling mechanism. Yet among the 22 utilities nationwide that use revenue or use per customer decoupling, only 4 apply the decoupling mechanism to all major rate classes, including the very largest users. Yet this minority approach is exactly what the Company is proposing.

TEC-RI submits that applying revenue per customer decoupling to all rate classes, including the largest users, is wrong. For example, when North Carolina granted decoupling for its gas utilities, it found that the different usage patterns and tariffs of industrial customers provided good cause to exclude that class from the mechanism.

Q. Is TEC-RI opposed to the Company's revenue decoupling proposal in this case?

A. Yes. TEC-RI is asking the Commission to deny the Company's request to institute the revenue decoupling mechanism proposed in this filing.

The risks to the ratepayer are likely to be substantial while the rewards are vague and perhaps illusory. The Company has the burden of proof, but it has not proven its case that instituting decoupling will bring additional benefits to customers in the form of additional efficiency services. If the goal is to increase energy efficiency and other demand resources, there are more effective ways to accomplish that.

Q. Should the Commission decide to grant the Company's revenue decoupling request in full or in part, what does TEC-RI suggest?

A. In that case, first, the Company's return on equity must be adjusted to reflect the lower risk to the stockholders.

Decoupling reduces risks that the utility faces, and transfers those risks to the ratepayers. Shareholders are compensated for business risk through the setting of a reasonable rate of return on their investment. Ratepayers cannot be required both to carry a risk and pay the Company for carrying it!

If a utility receives a rate mechanism that increases the probability that it will earn its allowed rate of return, a downward adjustment in its return on equity (ROE) is required. The more risk that is shifted to customers, the greater the downward adjustment to the ROE should be.

As a matter of fact, in addition to decoupling, there are other features of the Company's rate case that also shift risks to customers and therefore call for a downward adjustment in ROE. The pension and post-retirement benefits other than pensions (PBOPs) reconciling adjustment transfers the risk of exposure to cost increases from the utility to the ratepayer. And the annual uncollectible adjustment shifts the risk of higher uncollectibles away from the company to the ratepayer.

Second, the Large and Extra Large Rate Classes should be exempted entirely from the Revenue per Customer mechanism.

Third, should the Commission decide to grant the Company's request and include Large and Extra Large rate classes (despite sound reasons for not doing so), the Large and Extra Large rate class Revenue per Customer targets (RPCs) should be adjusted to remove the impact of customers that switched from non-firm to firm service after the test year (i.e., from October 2007 through January 2008).

Finally, should decoupling be put in place by the Commission, there should not be any "off-the-books" revenues. All revenue sources must be counted and added to the decoupling calculation as credits to revenue. Examples where this may be an issue include revenue from new C&I customers, and margins from interruptible customers.

III. DISTRIBUTION ADJUSTMENT CHARGE (DAC)

Q. What is TEC-RI's position on the DAC?

A. The Distribution Adjustment Charge (DAC) mechanisms should be redesigned to allocate costs to rate classes using revenues (as a proxy for cost of service allocation) rather than volumes when distributing revenue credits and debits to rate classes between rate cases.

The Company has documented the need to redesign rates to recover more distribution revenue through fixed and demand charges instead of volumetric charges. Continuing to rely on the DAC, with its recovery of revenues using a volumetric charge, runs directly contrary to this goal.

The Large and Extra Large rates have been redesigned so that a much larger share of company revenue comes from the demand charge. Why then should the adjustments to revenue on a year by year basis be made using a volumetric charge?

Base distribution rates primarily recover predominantly fixed costs related to plant, equipment, and customer services. These costs generally do not vary directly with usage. The Company continues to move costs that have tended to be more volatile, such as pension related costs and uncollectible expense, to the reconciling automatic adjustment known as the Distribution Adjustment Charge.

These costs are collected uniformly on a cents per therm basis.

By transferring cost recovery from base distribution rates to reconciling mechanisms, the effectiveness of rate design features is reduced, since the share of costs passing through base rates is decreased and the share of the bill driven by appropriate price signals declines . Over time, moving collection from base rates to the per therm DAC also distorts the cost of service. It allocates customer and demand driven costs to rate classes on the basis of a volumetric measure.

In this filing, the Company proposes to institute a separate DAC for each rate class. Thus, the Company's billing system will be able to handle different per therm adjustment rates for different classes.

TEC-RI asks the Commission to change the manner with which these adjustments are allocated to rate classes. They should be allocated to each rate class proportionately to class revenues, not class dekatherms. This more accurately reflects cost responsibility based on cost of service principles. Then those costs can be collected on the basis of a rate class-specific per-therm DAC charge.

IV. LOW INCOME DISCOUNT

Q. What is TEC-RI's position on the Low Income Discount?

A. First, the stockholders of the Company should contribute 50% of the cost of the low income discount, especially given the fact that the program will lower the uncollectibles and thereby contribute funds to the Company's earnings.

It is noble to offer someone a discount when you pick up the tab. It is less noble to offer someone a discount when you make someone else pick up the tab!

As of the date (July 24, 2008) that this testimony is being finalized, the Company has still not provided an answer to TEC-RI data request number 34 (submitted June 24, 2008), which asked the Company to identify the legal basis for the Company's proposal to fund a low income discount by charging the rest of the customers more money.

If the Company lacks the legal grounds to ask the Commission to take funds from the rest of the ratepayers to fund the low income discount, then the program must be justified some other way. Giving low income customers a discount can be considered a good business practice because it might help some customers to be able to afford the bill, and in other cases it was money you would not have received anyway (because it was destined to become a bad debt). So it makes sense that

the Company and the customers would contribute to the discount since there are benefits that accrue over time to both the stockholders and the ratepayers.

The Company claims that the low income discount will have no impact on uncollectibles, but it strains credulity to think that there is little or no overlap between uncollectible accounts and low income accounts. To the extent that low income customers are not paying their bills at all, the low income discount lowers the amounts they owe and thereby lowers the uncollectible amount. Also, in certain cases, the discount may make it possible for customers who would otherwise be unable to pay to instead pay the bill for services.

Second, the method for allocating the costs of this program to the other rate classes is unreasonable and should be corrected.

The Low Income Discount as proposed by the Company takes money from the other rate classes as a subsidy to the new two residential discount classes. Only residential customers are eligible for the discounted rate, yet the Company wants non-residential customers to help pay for the subsidy.

Moreover, the Company's proposal is unfair because it calls for the non-residential classes to shoulder over twice the relative burden as the residential classes would.

The following table takes values directly out of Company Attachment NG-DAH-3, and shows the relative burden placed on each rate class by calculating column (G) from that attachment, the low income discount revenue, as a percentage of column (D), the distribution revenue before the low income discount is applied:

from Attachment NG-DAH-3

Rate Schedule		Proposed Revenue before LI discount		Class Burden for LI Discount Revenue	Class Burden as % of Proposed Revenue
Residential Non-Heat	$	6,279,557	$	12,598	**0.20%**
Residential Heat	$	95,269,946	$	397,176	0.42%
Small CI	$	12,582,840	$	56,762	0.45%
Medium CI	$	16,348,798	$	126,540	0.77%
Large Low	$	7,511,321	$	63,733	0.85%
Large High	$	2,070,000	$	24,824	1.20%
X-Large low	$	1,338,688	$	28,958	2.16%
X-Large high	$	4,193,939	$	118,746	**2.83%**
Residential class	$	101,549,503	$	409,774	**0.40%**
Non-Residential class	$	44,093,312	$	419,563	**0.95%**

Therefore, as proposed by the Company, the non-residential class has over twice the burden (0.95%) as the residential class does (0.40%). Even worse, the Extra Large High Load Factor class has over ten times the burden (2.83%) as the Residential Non-Heating class does (0.20%)!

This gross disparity needs to be corrected.

Q. What is TEC-RI's proposal in this regard?

A. TEC-RI asks the Commission to order the Company to redesign its rates by allocating the revenue responsibility to pay for the Low Income Discount according to the distribution revenue before the discount. The distribution revenue before the discount is the best available mechanism to allocate any additional revenue responsibility in a fair and efficient manner.

V. GAS COST RECOVERY

Q. What is TEC-RI's position on the Gas Cost Recovery calculation?

A. The Company is proposing to reduce the number of Gas Cost Recovery (GCR) rates from six (6) to two (2) for the firm sales rate customers. TEC-RI asks the Commission to reject this proposal and keep the GCR rates at the current six. Reducing the GCR rates from six to two would be a significant and ill-advised step

away from true cost of service pricing. The cost of service for the GCR is not within the scope of this case, but it is TEC-RI's contention that significant differences in cost of service for the variable supply cost component of the GCR likely exist between the six current rate classes.

CONCLUSION

Q. Please briefly summarize the requests that TEC-RI is making in this docket.

A. Certainly.

(1) With respect to the Non-firm Tariff, we are asking the Commission to order the Company to comply with the Commission's directive in RIPUC docket No. 3887, specifically to file a cost of service based rate design for non-firm customers. The non-firm rate should have a similar structure as the corresponding firm tariff but represent an appropriate discount relative to that firm rate. The Commission should also require the Company to put in the tariff the rules it will follow in deciding to interrupt and restore customers. The proposal to eliminate the non-firm sales tariff should be put on hold pending an investigation of the harm that will come to customers currently being served on that tariff.

(2) With respect to Revenue Decoupling, we are asking the Commission not to approve the Company's proposal for revenue decoupling.

Should the Commission decide to grant the Company's revenue decoupling request, TEC-RI would ask for the following remedies:

a. The Company's return on equity should be adjusted downward to reflect the lower risk to stockholders.

b. The Large and Extra Large rate classes should be exempted entirely from the Revenue per Customer decoupling mechanism.

c. In the event that the Large and Extra Large rate classes are included in decoupling, the Revenue per Customer targets for these classes should be adjusted to remove the impact of customers that switched from non-firm to firm service after the test year.

d. All revenue sources must be added to the decoupling calculation as credits to revenue.

(3) With respect to the Distribution Adjustment Charge (DAC), we are asking the Commission to change the way adjustment dollars are allocated to rate classes. They should be allocated to each rate class proportionately to class revenues, not class dekatherms.

(4) With respect to the proposed Low Income Discount, we are asking the Commission to require the Company stockholders to contribute 50% of the costs of the discount, and to allocate the remaining costs among customer classes according to their class revenues rather than according to their dekatherm usage.

(5) With respect to the Gas Cost Recovery, we are asking the Commission to order the Company to keep the number of Gas Cost Recovery classes at their current six.

Q. Does this conclude your testimony?

A. Yes it does.

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Exhibit JF-1

TEC-RI MEMBERS

Amica Mutual Insurance Company
B. A. Ballou & Company, Inc.
Brown University
Bryant University
Calise & Sons Bakery, Inc.
Clariant Corporation
Cooley, Inc.
Colibri Group
Fairfield Resorts (The InnGroup)
Electric Boat
GTECH Corporation
Hasbro, Inc.
Hudson Companies
Hyatt Regency Newport
International Packaging Corporation
Jay Packaging Group
Johnson & Wales University
Kenney Manufacturing Company
Kenyon Industries
J. H. Lynch & Sons, Inc.
Mahr Federal Inc.
Matrix, Inc.
Microfibres, Inc.
The Moore Company
Newport Athletic Club
Newport Hospital
North Safety Equipment
Original Bradford Soapworks
OSRAM Sylvania
Pease and Curren
Polytop Corporation
Providence College
Raytheon Company
Rhode Island Hospital
Rhode Island School of Design
R.I. Dept. of Administration
Rhodes Technologies
Roger Williams University
Soluol Chemical Company, Inc.
Stanley-Bostitch
TACO Inc.
TECH Industries Inc.
Teknor Apex Company
Toray Plastics America Inc.
U.S. Naval Station Newport
UVEX Safety Inc.
Westerly Hospital

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