

June 25, 2008

VIA HAND DELIVERY & ELECTRONIC MAIL

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

RE: Docket 3960 – National Grid – Standard Offer Rate Adjustment Filing

Dear Ms. Massaro:

On behalf of National Grid,¹ I am writing to respond to the Position Memorandum of Patrick C. Lynch, Attorney General, which was submitted to the Rhode Island Public Utilities Commission (the “Commission”) on June 12, 2008 in the above-referenced docket.

At the outset, National Grid appreciates the Attorney General’s preface to the Memorandum, which compliments the Company and the way it has conducted its business. In addition, the Company understands the frustration faced by our customers with respect to rising energy costs, which are disturbing to us all. The purpose of this letter, however, is to respond to some of the other remarks in the Memorandum that the Company believes are important to address.

Specifically, it appears that the Attorney General is asking the Commission in this docket to take up the question of what the appropriate return on common equity should be for the Company’s distribution operations on a going forward basis. For the reasons explained below, this issue cannot be addressed in this proceeding. This proceeding relates to the Company’s standard offer service rate adjustment, where a significant build-up of under-recovered electricity commodity costs would occur without a timely adjustment to the standard offer service rate. This docket does not relate to the Company’s return on rate base for distribution service. The Company is entitled by statute to recover its commodity costs in providing standard offer service. RIGL § 39-1-27.3(b). Further, the Company’s distribution rates are subject to a rate plan settlement from Docket 3617 that does not permit a review of the company’s return on common equity unless the Company is exceeding its allowed return. In such case, there is a mechanism in place to share any excess earnings with customers. The Department of the Attorney General was a party to that settlement.

The Attorney General, in his Memorandum, refers to National Grid’s return on common equity, which is a consideration that has no application to the instant docket. Rather, the Company does not recover any profit margin on the sale of standard offer power supply. These types of questions just do not apply to a standard offer rate reconciliation such as this. They are issues that are determined in a distribution rate case such as the gas distribution rate case in PUC Docket No. 3943 or the electric rate case that was decided in PUC Docket No. 3617. In that type of docket, the

¹ The Narragansett Electric Company d/b/a National Grid (“Company”).

Commission sets rates that are just and reasonable and designed to recover the costs that are reasonably and prudently incurred by the Company in operating its distribution business. One important component of those costs is the Company's weighted average cost of capital, which includes the return on equity to which the Attorney General's Memorandum refers. In order to determine a return on equity, the Company's entire cost of service must be before the Commission. To adjust rates to lower or increase a Company's return on equity, there must be testimony with a factual and credible financial analysis supporting the decision. That is not the type of evidence that the Commission will consider in the instant standard offer rate adjustment filing.

In contrast, this case involves a review of the Company's application to adjust the standard offer service rate in accordance with its tariff in order to recover sufficient revenues to pay for electric power supply that is purchased on behalf of customers in the wholesale market. The adjustment of the standard offer rate is a completely separate matter from an electric distribution rate case. In fact, the rate for standard offer service is determined by the costs incurred from its wholesale standard offer supply contracts. There is no markup or profit for National Grid. Therefore, as the company's costs rise under the contracts, the standard offer rate must also be adjusted so that sufficient revenues are received from customers to pay for the electricity that they use. If the standard offer rate is not increased, the costs that are incurred for customer electric power purchases must be deferred for recovery at a later date. However, it never gets any easier for customers to pay for their electric supply. As a result, it is imperative that electric costs are paid as timely as possible in order to protect customers from even greater burdens in the future.

There also was a comment in the Memorandum that appears to suggest that the Commission may make a decision on standard offer cost recovery based on a policy pronouncement that "ratepayers should not have to bear the full economic impact of spiraling fuel costs by themselves" (Memorandum at 3). Although it is understandable that consumer advocates would find it very attractive to have the Commission simply order the Company to absorb electric power costs to mitigate bill impacts, the Company is compelled to point out that applicable legal and constitutional standards do not allow for ratemaking to be determined based on a principle of "sharing the pain." The Company has a legal right to recover the cost of electric supply that it has purchased for the direct benefit and use of Standard Offer service customers.

In addition, the Memorandum states that the General Assembly has "found" that the Company's return is sufficient if it falls in the range of 6% to 11%, and appears to ask the Commission to reduce the Company's return to a level closer to 6%. However, the "finding" referenced by the Attorney General was encompassed within a provision of the Utility Restructuring Act of 1996 (the "URA"), which related exclusively to the Company's electric operations and has since been repealed in relevant part. See, Narragansett Electric Co., Docket No. 3031, Order No. 16275, at 5, fn.25 (June 1, 2000), citing R.I.G.L. 39-1-27.5(a)(repealed). Specifically, to hold overall rate increases to the rate of inflation during the transition to a competitive electric market, the URA placed a moratorium on general rate increases during 1997 and 1998, which was designated as the "PBR Period." See, id. at 5 (fn.25) and 9. The "moratorium" was established by barring Narragansett from filing for a general rate increase during the PBR Period unless its earnings on common equity fell below 6% or rose above 11%. Id.

Luly E. Massaro, Commission Clerk
Response to RI Attorney General's Position
June 25, 2008
Page 3 of 3

As a result, it does not represent a finding that 6% is a fair or adequate return for the Company's electric operations in 2008 and forward.

Lastly, the memorandum appears to suggest the Company's return on equity is "virtually guaranteed" (at p.3). This statement also reflects a misunderstanding. As evidenced by the Company's earnings report filed May 1, 2008 for the twelve months ended December 31, 2007, the Company's return on equity was only 5.69%. This confirms the fact that the return on equity "allowed" in a rate case is by no means guaranteed. Moreover, as referenced above, beginning in 2004 Narragansett's electric distribution portion of its rates have generally been frozen until December 31, 2009 pursuant to the Second Amended Stipulation and Settlement in Docket No. 3617.

National Grid appreciates the opportunity to respond to the Attorney General's Memorandum.

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

Very truly yours,

A handwritten signature in blue ink, appearing to read "T. Teehan".

Thomas R. Teehan

cc: Docket 3960 Service List

Certificate of Service

I certify that a copy of the cover letter and materials accompanying this certificate were mailed or hand-delivered to the individuals listed below.



Date: June 25, 2008

Joanne M. Scanlon
National Grid

Narragansett Electric d/b/a National Grid
Docket No. 3960 – Standard Offer Rate Adjustment Filing
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