

September 18, 2008

**VIA HAND DELIVERY & ELECTRONIC MAIL**

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

**RE: Docket 3969 – Fuel Adjustment Factor Tariff Filing  
Responses to Commission Data Requests – Set 2**

Dear Ms. Massaro:

Enclosed please find ten (10) copies of National Grid's<sup>1</sup> responses to the second set of data requests issued by the Rhode Island Public Utilities Commission in the above-captioned proceeding.

If you have any questions concerning this matter, please feel free to contact me at (401) 784-7667.

Very truly yours,



Thomas R. Teehan

Enclosures

cc: Docket 3969 Service List

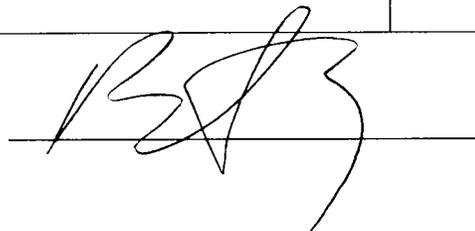
---

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

## CERTIFICATION

I hereby certify that I mailed a copy of the within Third Request for Confidential Treatment to counsel of record, as set forth below, on September 18, 2008.

<b>Name/Address</b>	<b>E-mail Distribution</b>	<b>Phone/FAX</b>
Thomas R. Teehan, Esq. National Grid. 280 Melrose St. Providence, RI 02907	<a href="mailto:Thomas.teehan@us.ngrid.com">Thomas.teehan@us.ngrid.com</a>	401-784-7667
	<a href="mailto:Joanne.scanlon@us.ngrid.com">Joanne.scanlon@us.ngrid.com</a>	401-784-4321
	<a href="mailto:Ronald.gerwatowski@us.ngrid.com">Ronald.gerwatowski@us.ngrid.com</a>	
Gerald Petros, Esq. Hinckley, Allen & Snyder 50 Kennedy Plaza, Suite 1500 Providence RI 02903	<a href="mailto:gpetros@haslaw.com">gpetros@haslaw.com</a>	401-274-2000
Paul Roberti, Esq. (for Division) Dept. of Attorney General 150 South Main St. Providence, RI 02903	<a href="mailto:Proberti@riag.ri.gov">Proberti@riag.ri.gov</a>	401-222-2424
	<a href="mailto:Steve.scialabba@ripuc.state.ri.us">Steve.scialabba@ripuc.state.ri.us</a>	401-222-3016
	<a href="mailto:Mtobin@riag.ri.gov">Mtobin@riag.ri.gov</a>	
	<a href="mailto:Kzelano@riag.ri.gov">Kzelano@riag.ri.gov</a>	
<b>Original &amp; nine (9) copies file w/:</b> Luly E. Massaro, Commission Clerk Public Utilities Commission 89 Jefferson Blvd. Warwick RI 02889	<a href="mailto:Lmassaro@puc.state.ri.us">Lmassaro@puc.state.ri.us</a>	401-780-2107
	<a href="mailto:Plucarelli@puc.state.ri.us">Plucarelli@puc.state.ri.us</a>	401-941-1691
	<a href="mailto:Anault@puc.state.ri.us">Anault@puc.state.ri.us</a>	
Kenneth W. Irvin, Esq. McDermott, Will & Emery LLP 600 13th Street, NW Washington, DC 20005	<a href="mailto:kirvin@mwe.com">kirvin@mwe.com</a>	202-756-8116 202-756-8087
Charles Henderson, Esq. Stacey Nakasian, Esq. Duffy Sweeney & Scott, Ltd. One Turks Head Plaza, Suite 1200 Providence, RI 02903	<a href="mailto:chenderson@duffysweeney.com">chenderson@duffysweeney.com</a> <a href="mailto:snakasian@duffysweeney.com">snakasian@duffysweeney.com</a>	401-455-0700



A handwritten signature in black ink, appearing to be 'RSD', is written over a horizontal line.

Commission Data Request 2-1

Request:

With regard to the estimated potential costs set forth on page 4, lines 14-16 of Mr. Gerwatowski's pre-filed testimony, have these figures been made public in any other context? If so, please provide copies of any documentation.

Response:

National Grid's Annual Report for the Fiscal Year ending March 31, 2008, has the following information about the litigation, quoted below, from page 34.

“Narragansett is in litigation with Constellation Energy Commodities Group (Constellation) in two cases. In the first case commenced on September 11, 2006 in the U.S. District Court for the District of Rhode Island, Constellation has alleged that certain power purchase agreements entitle it to additional compensation for capacity during calendar years 2006-2009, following the FERC-approved settlement in the forward capacity market. According to Constellation, the resolution of this claim “could adversely affect Constellation in amounts upwards of \$150 million.” In the second case commenced on April 14, 2008 in the U.S. District Court for the District of Massachusetts, Constellation has alleged that certain power purchase agreements entitle it to payments for a fuel adjustment factor during calendar years 2005-2009. The prospective portion of the fuel adjustment claim is subject to the effects of changing fuel prices. By Constellation's methodology for payment calculation, it is estimated that damages could exceed \$200 million. Narragansett is exploring its options to resolve these matters. Regardless of the outcome, Narragansett is entitled to recover all purchased power costs from customers under current law and legal precedent, however any request to recover increased costs that may result from resolution of these matters would be subject to approval by the Rhode Island Public Utility Commission.”

A copy of the referenced Annual Report is attached.

Prepared by or under the supervision of: Ronald T. Gerwatowski

# *National Grid USA*

## *Annual Report* *Fiscal year ended March 31, 2008*

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

### Report of Independent Auditors

To the Stockholder and Board of Directors of  
National Grid USA:

In our opinion, the accompanying consolidated balance sheets and statements of capitalization and the related consolidated statements of income, of comprehensive income, of retained earnings and of cash flows present fairly, in all material respects, the financial position of National Grid USA and its subsidiaries (the "Company") at March 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audit in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the standards of Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note A to the financial statements, the Company changed the manner in which it accounts for income taxes effective April 1, 2007 in accordance with Financial Interpretation 48, *Accounting for Uncertainty in Income Taxes* and the manner in which it accounts for pension and postretirement benefit plans effective March 31, 2007 in accordance with Financial Accounting and Standards Board Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

PricewaterhouseCoopers LLP

August 22, 2008

NATIONAL GRID USA AND SUBSIDIARY COMPANIES

Consolidated Statements of Income

(In millions of dollars)

	<b>For the years ended March 31,</b>	
	2008	2007
Operating revenues		
Electric	\$ 7,609.6	\$ 6,944.4
Gas	5,694.6	1,218.0
Energy services and investments	95.2	-
Total operating revenues	<b>13,399.4</b>	8,162.4
Operating expenses		
Purchased energy		
Electricity purchased	3,492.8	3,483.9
Gas purchased	3,804.9	814.9
Contract termination charges and nuclear shutdown charges	40.0	63.8
Other operation and maintenance	2,801.3	1,691.6
Depreciation, depletion and amortization	642.5	411.0
Amortization of regulatory assets, stranded costs and rate plan deferrals	531.9	455.6
Other taxes	630.6	342.7
Income taxes	354.8	188.0
Total operating expenses	<b>12,298.8</b>	7,451.5
Operating income	<b>1,100.6</b>	710.9
Other income (deductions)	24.1	28.4
Operating and other deductions	<b>1,124.7</b>	739.3
Interest expense:		
Interest on long-term debt	328.7	138.6
Other interest, including affiliate interest	176.4	138.8
Total interest expense, net	<b>505.1</b>	277.4
<b>Net income from continuing operations</b>	<b>619.6</b>	461.9
<b>Discontinued operations:</b>		
Income from discontinued operations, net of tax expense of \$21.7 million and \$10.6 million	27.8	11.7
Gain (loss ) on sale of discontinued businesses, net of tax	15.2	(120.2)
<b>Net income (loss) from discontinued operations</b>	<b>43.0</b>	(108.5)
<b>Net income</b>	<b>\$ 662.6</b>	\$ 353.4

*The accompanying notes are an integral part of these consolidated financial statements.*

NATIONAL GRID USA AND SUBSIDIARY COMPANIES  
Consolidated Statements of Comprehensive Income  
(In millions of dollars)

	For the years ended March 31,	
	2008	2007
Net income	\$ 662.6	\$ 353.4
Other comprehensive (loss) income, net of taxes:		
Unrealized (gains) losses on investments	(13.6)	6.0
Unrealized gain/(loss) on hedges	14.2	(17.5)
Change in additional minimum pension liability	-	(6.3)
Change in pension and other post-retirement obligations	(100.5)	-
Reclassification adjustment for gains (losses) included in net income	17.8	18.5
Total other comprehensive (loss) income	(82.1)	0.7
Comprehensive income	\$ 580.5	\$ 354.1
Adjustment to initially apply SFAS No. 158	-	(398.1)
Change in accumulated other comprehensive income (loss)	\$ 580.5	\$ (397.4)
Related tax expense (benefit):		
Unrealized (losses) gains on investments	\$ (9.1)	\$ 4.0
Unrealized gain (loss) on hedges	9.5	(11.7)
Change in pension and other post-retirement obligations	(67.0)	-
Change in additional minimum pension liability	-	(4.2)
Reclassification adjustment for gains (losses) included in net income	11.8	12.3
Total tax expense (benefit)	\$ (54.8)	\$ 0.4

NATIONAL GRID USA AND SUBSIDIARY COMPANIES  
Consolidated Statements of Retained Earnings  
(In millions of dollars)

	For the years ended March 31,	
	2008	2007
Retained earnings at beginning of period	\$ 1,550.0	\$ 1,484.6
Adoption of new accounting standard FIN 48	(8.4)	-
Adjusted balance at beginning of period	1,541.6	1,484.6
Net income	662.6	353.4
Dividends on preferred stock	(1.9)	(2.1)
Dividends on common stock	-	(286.1)
Return of capital to parent company	(327.7)	-
Other	(0.4)	0.2
<b>Retained earnings at end of period</b>	<b>\$ 1,874.2</b>	<b>\$ 1,550.0</b>

*The accompanying notes are an integral part of these consolidated financial statements*

NATIONAL GRID USA AND SUBSIDIARY COMPANIES  
Consolidated Balance Sheets  
(In millions of dollars)

<b>ASSETS</b>	<b>March 31,</b>	
	<b>2008</b>	<b>2007</b>
Assets:		
Property plant and equipment, net	<b>17,410.2</b>	9,689.2
Goodwill	<b>7,326.5</b>	3,338.8
Other property and investments	<b>504.2</b>	316.3
Current assets:		
Cash and cash equivalents	<b>1,169.9</b>	281.9
Restricted cash	<b>19.2</b>	63.1
Accounts receivable (less reserves of \$305.5 and \$165.2, respectively, including \$64.1 million and \$10.4 million from affiliates respectively)	<b>2,173.5</b>	1,066.6
Unbilled revenue	<b>941.2</b>	351.0
Inventories, at average cost:		
Gas in storage	<b>336.5</b>	20.9
Other	<b>389.3</b>	59.7
Derivative contracts	<b>171.0</b>	7.9
Current portion of accumulated deferred income taxes	<b>188.5</b>	176.2
Current portion of regulatory assets	<b>204.9</b>	304.0
Assets of discontinued operations	<b>3,025.4</b>	305.1
Other	<b>392.0</b>	161.8
<b>Total current assets</b>	<b>9,011.4</b>	2,798.2
Other non-current assets:		
Regulatory assets	<b>5,968.3</b>	5,101.4
Derivative contracts	<b>128.6</b>	-
Intangible assets, net of amortization	<b>230.9</b>	-
Other	<b>276.1</b>	67.7
<b>Total other non-current assets</b>	<b>6,603.9</b>	5,169.1
<b>Total assets</b>	<b>\$ 40,856.2</b>	\$ 21,311.6

*The accompanying notes are an integral part of these consolidated financial statements.*

NATIONAL GRID USA AND SUBSIDIARY COMPANIES  
Consolidated Balance Sheets  
(In millions of dollars)

CAPITALIZATION AND LIABILITIES	March 31,	
	2008	2007
Capitalization:		
Common stockholder's equity:		
Common stock (\$.10 par value)	\$ -	\$ -
Authorized - 3000 shares		
Issued and outstanding -1000 shares		
Additional paid-in capital	14,043.4	7,599.0
Retained earnings	1,874.2	1,550.0
Accumulated other comprehensive income (loss)	(483.8)	(401.7)
Total common stockholder's equity	15,433.8	8,747.3
Minority interest in subsidiaries	19.3	16.4
Cumulative preferred stock, par value \$ 100 per share	34.8	52.3
Long-term debt	5,391.2	1,968.5
Long-term debt to affiliates	1,200.0	1,200.0
Total capitalization	22,079.1	11,984.5
Current liabilities:		
Accounts payable	1,917.1	698.4
Customers' deposits	107.6	51.3
Accrued interest	199.8	75.1
Accrued taxes	301.1	33.2
Short-term debt due to affiliates	1,136.4	1,028.9
Current portion of long-term debt	992.6	218.9
Commercial paper	1,115.0	-
Notes payable - Other	298.0	-
Current portion of accrued Yankee nuclear plant costs	23.2	28.5
Liabilities of discontinued operations	1,860.8	34.9
Current regulatory liabilities	322.8	129.3
Other, including derivative contracts	261.3	458.8
Total current liabilities	8,535.7	2,757.3
Other non-current liabilities:		
Accumulated deferred income taxes	2,443.3	2,050.2
Derivates and swap contracts	150.6	254.7
Accrued employee pension and other benefits and other reserves	2,864.7	1,570.7
Environmental remediation costs	1,282.9	582.8
Regulatory liabilities, miscellaneous	1,159.2	846.6
Regulatory liabilities - removal costs recovered	1,305.9	642.2
Regulatory liabilities derivative accounts	128.1	2.3
Other	906.7	620.3
Total non-current liabilities	10,241.4	6,569.8
<b>Total capitalization and liabilities</b>	<b>\$ 40,856.2</b>	<b>\$ 21,311.6</b>

*The accompanying notes are an integral part of these consolidated financial statements.*

NATIONAL GRID USA AND SUBSIDIARY COMPANIES  
Consolidated Statements of Cash Flows  
(In millions of dollars)

	For the years ended March 31,	
	2008	2007
Operating activities:		
Net income	\$ 662.6	\$ 353.4
Adjustments to reconcile net income to net cash provided by operating activities:		
Net (income) loss from discontinued operations	(43.0)	108.5
Depreciation and amortization	642.5	411.0
Amortization of stranded costs and rate plan deferrals	531.9	455.6
Income from equity investments	(8.6)	-
Dividends from equity investments	7.5	-
Merger related and other non-cash charges	(47.5)	(28.3)
Provision for deferred federal and state income taxes and investment tax credits	(76.6)	108.6
Changes in operating assets and liabilities:		
Accounts receivable, net	(803.9)	(19.1)
Materials and supplies	357.7	27.4
Prepays and other current assets	(64.4)	(59.1)
Accounts payable and accrued expenses	199.8	(10.6)
Pension and postretirement regulatory assets	(271.8)	(117.7)
Purchased power obligations	5.8	(0.2)
Other, net	61.9	(78.4)
Net cash provided by operating activities	1,153.9	1,151.2
Investing activities:		
Plant expenditures	(1,105.6)	(787.2)
Acquisitions	(7,545.1)	(496.7)
Net proceeds from sale of subsidiary and assets	313.8	1.9
Change in restricted cash	43.9	17.2
Other, net	40.9	64.8
Net cash used in investing activities	(8,252.1)	(1,200.0)
Financing activities:		
Dividends paid on common and preferred stock	(43.6)	(288.2)
Dividends paid on common stock of minority interests	(2.1)	(2.2)
Return of capital to parent company	(327.7)	-
Capital contribution from parent for acquisitions	7,545.1	500.0
Payment of long-term debt	-	(317.3)
Proceeds from long-term debt	147.3	-
Redemption of preferred stock	(18.0)	-
Buyback of minority interest common stock	(1.3)	(1.7)
Buyback of common stock	(1,075.5)	-
Net change in short-term debt to affiliates	107.5	384.7
Net change in short-term debt	1,130.6	-
Capital contribution to discontinued operations	-	(158.8)
Net cash provided by financing activities	7,462.4	116.6
Net increase in cash and cash equivalents	364.2	67.9
Cash flow from discontinued operations - Operating Activities	(2.0)	18.2
Cash flow from discontinued operations - Investing Activities	(20.1)	(176.9)
Cash flow from discontinued operations - Financing Activities	(9.5)	158.8
Cash transferred from KeySpan	555.4	-
Cash and cash equivalents, beginning of period	281.9	214.0
Cash and cash equivalents, at end of period	1,169.9	281.9
Supplemental disclosures of cash flow information:		
Interest paid	458.3	255.2
Taxes paid	413.1	252.8

*The accompanying notes are an integral part of these consolidated financial statements.*

NATIONAL GRID USA AND SUBSIDIARY COMPANIES  
Consolidated Statement of Capitalization  
(in millions of dollars)

	March 31, 2008	March 31, 2007	March 31, 2008	March 31, 2007
<b>Common Shareholders' Equity</b>				
	<b>Shares Issued</b>		<b>Amounts</b>	
Common stock, \$0.01 par value	1,000	1,000	\$ -	\$ -
Additional Paid in Capital			14,043.4	7,599.0
Retained earnings			1,874.2	1,550.0
Accumulated other comprehensive loss			(483.8)	(401.7)
<b>Total Common Shareholders' Equity</b>			<b>15,433.8</b>	<b>8,747.3</b>
Minority Interest in Subsidiaries			19.3	16.4
Cumulative Preferred Stock, \$100 and \$50 par value	944	1,000	34.8	52.3
<b>Long - Term Debt</b>				
	<b>Interest Rate</b>		<b>Amounts</b>	
<b>Medium and Long - Term Debt</b>	3.55% - 5.51%	-	159.1	-
	4.65% - 9.75%	7.30% -9.41%	3,456.3	861.9
<b>Total Medium and Long-Term Debt</b>			<b>3,615.4</b>	<b>861.9</b>
<b>Gas Facilities Revenue Bonds</b>	Variable	-	230.0	-
	4.70% - 6.95%	-	410.5	-
<b>Total Gas Facilities Revenue Bonds</b>			<b>640.5</b>	<b>-</b>
<b>Promissory Notes to LIPA</b>				
Pollution Control Revenue Bonds	5.15%	-	108.0	-
Electric Facility Revenue Bonds	5.30%	-	47.4	-
<b>Total Promissory Notes to LIPA</b>			<b>155.4</b>	<b>-</b>
Industrial Development Bonds	5.25%	-	128.3	-
First Mortgage Bonds	5.72% - 10.25%	5.72% - 10.25%	205.1	171.7
State Authority Financing Bonds	Variable	Variable	1,219.9	1,155.5
Committed Facilities	Variable	-	382.5	-
Inter-Company Notes	5.52%	5.52%	1,200.0	1,200.0
Subtotal			7,547.1	3,389.1
Fair value adjustment and unamortized interest rate hedge			36.7	(1.7)
Less: current maturities			992.6	218.9
<b>Total Long - Term Debt</b>			<b>6,591.2</b>	<b>3,168.5</b>
<b>Total Capitalization</b>			<b>\$ 22,079.1</b>	<b>\$ 11,984.5</b>

*The accompanying notes are an integral part of these consolidated financial statements*

## **NATIONAL GRID USA AND SUBSIDIARY COMPANIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

### **NOTE A - SIGNIFICANT ACCOUNTING POLICIES**

#### **1. Nature of Operations**

National Grid USA (referred to in the Notes to the Consolidated Financial Statements as the Company, NGUSA, we, us, and our) is a public utility holding company with regulated subsidiaries engaged in the transmission, distribution, and sale of both electricity and natural gas. The Company is a wholly owned subsidiary of National Grid plc (the Parent).

On August 24, 2007, the Company acquired KeySpan Corporation (KeySpan and the KeySpan Acquisition) including its subsidiaries and its service companies (see Note L –Acquisitions). The Company’s electricity and gas distribution subsidiaries now serve over six million customers in New York State, Massachusetts, Rhode Island and New Hampshire. The Company’s New England subsidiaries include: New England Power Company (NEP), The Narragansett Electric Company (Narragansett), Massachusetts Electric Company (Mass Electric), Nantucket Electric Company (Nantucket Electric), Granite State Electric Company (Granite State), New England Hydro-Transmission Electric Company, Inc., New England Hydro-Transmission Corporation, New England Hydro Finance Company, Inc., Boston Gas Company, Colonial Gas Company, Essex Gas Company and EnergyNorth Natural Gas Inc., collectively referred to as KeySpan Energy Delivery New England (KEDNE). The Company’s New York subsidiaries include: Niagara Mohawk Power Corporation (Niagara Mohawk), KeySpan Energy Delivery New York (KEDNY) and KeySpan Energy Delivery Long Island (KEDLI).

Additionally, Company subsidiaries operate the electric transmission and distribution system owned by the Long Island Lightning Company (LIPA), in Nassau and Suffolk Counties in Long Island. The Company also owns and provides capacity to and produces energy for LIPA from our generating facilities located on Long Island and manages fuel supplies for LIPA to fuel our Long Island generating facilities. These services are provided in accordance with existing long-term service contracts having remaining terms that range from one to six years and power purchase agreements having remaining terms that range from six to 20 years. On February 1, 2006, KeySpan and LIPA agreed to extend, amend and restate these contractual arrangements. (See Note N, “2006 LIPA Settlement” for a further discussion of these agreements.)

Company subsidiaries also own or lease and operate the 2,200 MW Ravenswood Facility located in Queens, New York, and the 250 MW combined-cycle Ravenswood Expansion. Collectively the Ravenswood Facility and Ravenswood Expansion are referred to as the “Ravenswood Generating Station.” To finance the purchase and/or construction of the Ravenswood Generating Station, KeySpan entered into a leasing arrangement for each facility. (See Note C, “Commitments and Contingencies” for further details on the leasing arrangements.)

The NYPSC required the divestiture of the Ravenswood Generating Station as a condition for their approval of the KeySpan Acquisition. Accordingly, the Ravenswood Generating Station is reflected as discontinued operations on the Consolidated Statement of Income, Consolidated Balance Sheet and Consolidated Statement of Cash Flows. The Company has unregulated

subsidiaries engaged in the construction, leasing, and ownership of telecommunications infrastructure, and in engineering and consulting services that are also classified as discontinued operations (see Note M, “Discontinued Operations”).

The Company’s other operating subsidiaries are primarily involved in gas production and development, underground gas storage, liquefied natural gas storage, retail electric marketing, service and maintenance of energy systems, and the development of natural gas pipelines and other energy-related projects. Additionally, the Company has an equity ownership interest in two hydro-transmission electric companies as well as a minority ownership interest in three regional nuclear generating companies that own generating facilities that have been decommissioned.

## **2. Basis of Presentation**

The Company’s accounting policies conform to generally accepted accounting principles in the United States of America (US GAAP), including accounting principles for rate-regulated entities with respect to the Company’s subsidiaries engaged in the transmission and distribution of gas and electricity (regulated subsidiaries), and are in accordance with the accounting requirements and ratemaking practices of the regulatory authorities having jurisdiction (see Item 4 “Regulation”).

The consolidated financial statements include the accounts of the Company and all of its wholly-owned subsidiaries and entities for which the Company has control. Investments in which the Company can exercise significant influence over the operations of the investee (generally where the Company owns 20% of the investee but not in excess of 50%) are accounted for under the equity method of accounting. All intercompany transactions and balances between consolidated subsidiaries have been eliminated in consolidation.

The results of operations for companies acquired or disposed of are included in the consolidated financial statements from the effective date of acquisition or up to date of disposal.

Upon acquisition, KeySpan aligned certain of its accounting policies with National Grid’s policies. Specifically and most importantly, KeySpan adjusted certain assumptions underlying the calculations for its pension and other postretirement reserves to align those assumptions with National Grid’s pension and postretirement reserve assumptions where appropriate. Additionally, KeySpan adjusted certain assumptions underlying the calculations for its environmental reserve to align those assumptions with National Grid’s environmental reserve assumptions where appropriate. (See Note L “Acquisitions” for additional details on the accounting policy changes.)

## **3. Use of Estimates**

The preparation of financial statements in conformity with US GAAP requires management to make estimates that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities as of the date of the balance sheets, and revenues and expenses for the period. These estimates may differ from actual amounts if future circumstances cause a change in the assumptions used to calculate these estimates.

For the fiscal year ended March 31, 2008, the Company revised certain assumptions used to determine the reported amount of derivative liabilities. The revision was primarily due to changes

in market price forecasts. The changes had the effect of reducing the derivative liability by approximately \$50.3 million. The changes had no effect on the Consolidated Statements of Income for the period ending March 31, 2008 as the corresponding regulatory asset was adjusted by the same amount. See note B – “Rate and Regulatory.”

#### **4. Regulation**

The Federal Energy Regulatory Commission (FERC) has jurisdiction over certain of our holding company activities, including (i) regulating certain transactions among our affiliates within our holding company system; (ii) governing the issuance, acquisition and disposition of securities and assets by certain of our public utility subsidiaries; and (iii) approving certain utility mergers and acquisitions.

Moreover, our affiliate transactions also remain subject to certain regulations of the New York State Public Service Commission (NYPSC), the Massachusetts Department of Public Utilities (MADPU), the New Hampshire Public Utility Commission (NHPUC) and the Rhode Island Public Utility Commission (RIPUC) in addition to FERC.

Under our holding company structure, we have no independent operations or source of income of our own and conduct all of our operations through our subsidiaries and, as a result, we depend on the earnings and cash flow of, and dividends or distributions from, our subsidiaries to provide the funds necessary to meet our debt and contractual obligations. Furthermore, a substantial portion of our consolidated assets, earnings and cash flow is derived from the operations of our regulated utility subsidiaries, whose legal authority to pay dividends or make other distributions to us is subject to regulation by state regulatory authorities, (See Note B – “Rate and Regulatory” ).

#### **5. Goodwill**

National Grid plc’s acquisitions of the Company’s subsidiaries, including the acquisitions by the Company of Eastern Utilities Associates (EUA), Niagara Mohawk, the Rhode Island gas assets of New England Gas Company and KeySpan (see Note L – “Acquisitions”), were accounted for by the purchase method, the application of which includes the recognition of goodwill. Goodwill was approximately \$7.3 billion and \$3.3 billion at March 31, 2008 and 2007, respectively. In accordance with the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 142, “Goodwill and Other Intangible Assets,” the Company reviews its goodwill annually for impairment and whenever indicators of impairment are present. The Company utilized a discounted cash flow approach incorporating its most recent business plan forecasts in the performance of the annual goodwill impairment test. The result of the annual analysis determined that no impairment adjustment to goodwill carrying value was required.

During fiscal year 2008, goodwill increased by approximately \$4.0 billion, primarily related to the KeySpan Acquisition. Additionally, the Company recorded an adjustment to goodwill during the current fiscal year of \$49.5 million upon adoption of Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), “Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109,” related to the pre-merger period in fiscal year 2008. See Note G – “Income Taxes”. During fiscal year 2007, goodwill increased by approximately \$262 million. This amount primarily related to (i) an increase to Narragansett goodwill of \$236 million due to the acquisition of the Rhode Island gas assets from Southern Union Company and

(ii) an increase to Niagara Mohawk of \$26 million due to an adjustment related to a tax contingency.

## **6. Revenue Recognition**

***Electric and Gas Utility Services:*** The Company's regulated subsidiaries charge customers for electric and gas service in accordance with rates approved by FERC and the applicable state regulatory commissions.

The Company's distribution subsidiaries follow the policy of accruing the estimated amount of base rate revenues for electricity and gas delivered but not yet billed (unbilled revenues), to match costs and revenues. The unbilled revenue included in accounts receivable at March 31, 2008 and 2007 was approximately \$941.2 million and \$351 million, respectively. The distribution subsidiaries record revenues in amounts management believes to be recoverable pursuant to provisions of approved settlement agreements and state legislation. The distribution subsidiaries normalize the difference between revenue and expenses from energy conservation programs, commodity purchases, transmission service and contract termination charges.

KEDNY, KEDLI, Niagara Mohawk and Narragansett gas utility tariffs contain weather normalization adjustments that largely offset shortfalls or excesses of firm net revenues (revenues less gas costs and revenue taxes) during a heating season due to variations from normal weather. Revenues are adjusted each month the clause is in effect. Gas utility rate structures for the other gas distribution subsidiaries contain no weather normalization feature; therefore their net revenues are subject to weather related demand fluctuations. As a result, fluctuations from normal weather may have a significant positive or negative effect on the results of these operations. To mitigate the effect of fluctuations from normal weather on our financial position and cash flows, we may enter into weather related derivative instruments from time to time. (See Note E, "Derivative Contracts and Hedging Activities" for additional information on these derivatives.)

***LIPA Agreements:*** In 1998, KeySpan and LIPA entered into three major long-term service agreements that (i) provide to LIPA all operation, maintenance and construction services and significant administrative services relating to the Long Island electric transmission and distribution (T&D) System pursuant to the Management Services Agreement (the "1998 MSA"); (ii) supply LIPA with electric generating capacity, energy conversion and ancillary services from our Long Island generating units pursuant to the Power Supply Agreement (the "1998 PSA"); and (iii) manage all aspects of the fuel supply for our Long Island generating facilities, as well as all aspects of the capacity and energy owned by or under contract to LIPA pursuant to the Energy Management Agreement (the "1998 EMA"). The 1998 MSA, 1998 PSA and 1998 EMA all are collectively referred to as the "1998 LIPA Agreements".

On February 1, 2006, KeySpan and LIPA entered into (i) an amended and restated Management Services Agreement (the "2006 MSA"), pursuant to which KeySpan will continue to operate and maintain the electric T&D System owned by LIPA on Long Island; (ii) a new Option and Purchase and Sale Agreement (the "2006 Option Agreement"), to replace the Generation Purchase Rights Agreement (as amended, the "GPRA"), pursuant to which LIPA had the option, through December 15, 2005, to effectively acquire substantially all of the electric generating facilities owned by KeySpan on Long Island; and (iii) a Settlement Agreement (the "2006 Settlement Agreement") resolving outstanding issues between the parties regarding the 1998

LIPA Agreements. The 2006 MSA, the 2006 Option Agreement and the 2006 Settlement Agreement are collectively referred to herein as the “2006 LIPA Agreements.” The applicable rate components of each of the 2006 LIPA agreements became effective retroactive to January 1, 2006 upon receipt of all the required governmental approvals in 2007. (See Note N, “2006 LIPA Settlement “for additional details on these agreements).

The Company’s compensation for managing the electric transmission and distribution system owned by LIPA under the 2006 MSA consists of two components: a minimum compensation component of \$224 million per year and a variable component based on electric sales. The \$224 million component will remain unchanged for three years and then increase annually by 1.7%, plus inflation. The variable component, which will comprise no more than 20% of KeySpan’s compensation, is based on electric sales on Long Island exceeding a base amount of 16,558 gigawatt hours, increasing by 1.7% in each year. Above that level, the Company will receive approximately 1.34 cents per kilowatt hour for the first contract year, 1.29 cents per kilowatt hour in the second contract year (plus an annual inflation adjustment), 1.24 cents per kilowatt hour in the third contract year (plus an annual inflation adjustment), with the per kilowatt hour rate thereafter adjusted annually by inflation.

In addition, the Company sells to LIPA under the 1998 PSA all of the capacity and, to the extent requested, energy conversion services from its existing Long Island based oil and gas-fired generating plants. Sales of capacity and energy conversion services are made under rates approved by the FERC. Rates charged to LIPA include a fixed and variable component. The variable component is billed to LIPA on a monthly per megawatt hour basis and is dependent on the number of megawatt hours dispatched. The 1998 PSA provides incentives and penalties that can total \$4 million annually for the maintenance of the output capability and the efficiency of the generating facilities.

Pursuant to the 1998 EMA, the Company (i) procures and manages fuel supplies for LIPA to fuel KeySpan’s Long Island based generating facilities acquired from LILCO in 1998; (ii) performs off-system capacity and energy purchases on a least-cost basis to meet LIPA’s needs; and (iii) makes off-system sales of output from the Long Island based generating facilities and other power supplies either owned or under contract to LIPA. In exchange for these services we earn an annual fee of \$1.5 million. LIPA is entitled to two-thirds of the profit from any off-system energy sales arranged by us. In addition, the 1998 EMA provides incentives and penalties that can total \$5 million annually for performance related to fuel purchases and off-system power purchases. The original term for the fuel supply service described in (i) is 15 years, expiring May 28, 2013 and the original term for the off-system purchases and sales services described in (ii) and (iii), collectively, “Power Supply Management Services” was eight years, expiring May 28, 2006. The term for the Power Supply Management Services has been extended several times, most recently in 2007 when the parties amended the EMA to extend the term for such services until December 31, 2009, provided that LIPA shall have the right to terminate the Power Supply Management Services at any time upon 60 days prior notice.

In October 2007, LIPA issued a Request for Proposal (RFP) to provide Power Supply Management Services commencing in October 2009. National Grid submitted a bid in response to the RFP. On June 26, 2008, LIPA announced that it had selected another bidder to provide these services effective October 1, 2009. The Company will continue to supply fuel procurement services under the EMA. The loss of the Power Supply Management Services is not expected to

have a material impact to the Company's results of operations or cash flows.

## 7. Property, Plant and Equipment

Property, plant and equipment is stated at original cost for property acquired prior to the KeySpan Acquisition. Property, plant and equipment related to KeySpan and its subsidiaries is stated at original cost less accumulated depreciation up to the date of acquisition. Accumulated depreciation for KeySpan and its subsidiaries reflects additions to the reserve balance from the date KeySpan was acquired. The cost of additions to utility plant and replacements of retired units of property are capitalized. Costs include direct material, labor, overhead and allowance for funds used during construction (AFUDC) (see Item 8 "AFUDC" below). Replacement of minor items of utility plant and the cost of current repairs and maintenance are charged to expense. Whenever utility plant is retired, its original cost, together with the cost of removal, less salvage, is charged to accumulated depreciation.

(in millions of dollars)	At March 31,	
	2008	2007
Property Plant and Equipment		
Electric plant	\$ 12,853.8	\$ 11,519.0
Gas plant	8,195.2	2,145.4
Common and other plant	720.5	358.1
Construction work-in-process	527.6	259.8
Total utility plant	22,297.1	14,282.3
Less: accumulated depreciation and amortization	(4,924.0)	(4,593.1)
Net property plant and equipment	17,373.1	9,689.2
Gas production	39.1	-
Less: depletion	(2.0)	-
Net gas production plant	37.1	-
Total Plant	\$ 17,410.2	\$ 9,689.2

## 8. AFUDC

The Company capitalizes AFUDC as part of construction costs in amounts equivalent to the cost of funds devoted to plant under construction for its regulated businesses. AFUDC represents the composite interest and equity costs of capital funds used to finance that portion of construction costs not yet eligible for inclusion in rate base. AFUDC is capitalized in "Utility plant" with offsetting cash credits to "Other interest" and non-cash credits to "Other income (deductions), net." This method is in accordance with established rate-making practices under which our utility subsidiaries are permitted to earn a return on, and the recovery of, prudently incurred capital costs through their ultimate inclusion in rate base and in the provision for depreciation. AFUDC rates vary by Company and regulatory jurisdiction.

Capitalized interest for the year ended 2008 and 2007 was \$9.1 million and \$11.8 million respectively and is reflected as a reduction to interest expense.

## 9. Depreciation and Amortization

Depreciation expense is determined using the straight-line method. The depreciation rates for the Company's gas and electric subsidiaries are based on periodic studies of the estimated useful lives of the assets and the estimated cost to remove them net of salvage value. The Company's gas and electric subsidiaries use composite depreciation rates that are approved by the respective federal and state utility commissions. The provision for depreciation as a percentage of weighted

average depreciable property (excluding construction work-in-progress) was 3.20 percent and 3.03 percent for the fiscal years ended March 31, 2008 and 2007, respectively.

Regulatory assets, including those covered by contract termination charges, are amortized in accordance with the provisions of the regulated subsidiaries' rate settlement agreements and, therefore, are not necessarily amortized on a straight-line basis. NEP and Niagara Mohawk had deferred certain costs related to deregulation, including purchased power contract buyouts, and losses on the sale of generation assets as a regulatory asset (See Note B – "Rates and Regulatory"). Niagara Mohawk's costs are being amortized unevenly over ten years with larger amounts being amortized in the latter years, consistent with projected recovery through rates.

We also had \$1.2 billion of other property at March 31, 2008, consisting of \$527.6 million of construction work in progress with the remaining assets held by our corporate service subsidiary and our non regulated subsidiaries. These assets consist largely of land, buildings, office equipment, furniture, vehicles, computer and telecommunications equipment and systems. These assets have depreciable lives ranging from 3 to 40 years. We allocate the carrying cost of corporate service assets to our operating subsidiaries.

#### **10. Cash Equivalents**

The Company classifies short-term investments with an original maturity of three months or less as cash equivalents.

#### **11. Restricted Cash**

Restricted cash consists of margin accounts for commodity and interest rate hedging activity, health care claims deposits, New York State Department of Conservation securitization for certain site cleanup, and workers' compensation premium deposits.

#### **12. Federal and State Income Taxes**

Federal and State income taxes are recorded under the provisions of SFAS No. 109 "Accounting for Income Taxes." Income taxes have been computed utilizing the asset and liability approach that requires the recognition of deferred tax assets and liabilities for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. Deferred investment tax credits are amortized over the useful life of the underlying property. Effective April 1, 2007, the Company implemented FASB issued FIN 48 "Accounting for Uncertainty in Income Taxes – an interpretation of FASB No. 109" which applies to all income tax positions reflected on the Company's Consolidated Balance Sheet that have been included in previous tax returns or are expected to be included in future tax returns. FIN 48 addresses the methodology to be used prospectively in recognizing related interest and penalties. See Note G – "Income Taxes" for the impact of the adoption of FIN 48.

#### **13. Derivatives**

From time to time, we employ derivative instruments to hedge a portion of our exposure to commodity price risk, interest rate risk and weather fluctuations. Prior to January 1, 2008, KeySpan employed derivative financial instruments to hedge cash flow variability associated with a portion of its peak electric energy sales. Whenever hedge positions are in effect, we are exposed to credit risk in the event of nonperformance by counter-parties to derivative contracts, as well as nonperformance by the counter-parties of the transactions against which they are

hedged. We believe that the credit risk related to the futures, options and swap instruments is no greater than that associated with the primary commodity contracts which they hedge.

***Financially-Settled Commodity Derivative Instruments.*** We employ derivative financial instruments, such as futures, options and swaps, for the purpose of hedging the cash flow variability associated with forecasted purchases and sales of various energy-related commodities. All such derivative instruments are accounted for pursuant to the requirements of SFAS 133 “Accounting for Derivative Instruments and Hedging Activities,” as amended by SFAS 149, “Amendment of Statement 133 Derivative Instruments and Hedging Activities” (collectively, SFAS 133). With respect to those commodity derivative instruments that are designated and accounted for as cash flow hedges, the effective portion of periodic changes in the fair market value of cash flow hedges is recorded as accumulated other comprehensive income on the Consolidated Balance Sheet, while the ineffective portion of such changes in fair value is recognized in earnings. Unrealized gains and losses (on such cash flow hedges) that are recorded as accumulated other comprehensive income are subsequently reclassified into earnings concurrent when hedged transactions impact earnings. With respect to those commodity derivative instruments that are not designated as hedging instruments, such derivatives are accounted for on the Consolidated Balance Sheet at fair value, with all changes in fair value reported in earnings.

***Firm Gas Sales Derivatives Instruments – Regulated Utilities.*** We use derivative financial instruments to reduce cash flow variability associated with the purchase price for a portion of future natural gas purchases associated with our gas distribution operations. Our strategy is to minimize fluctuations in firm gas sales prices to our regulated firm gas sales customers in our service territories. The accounting for these derivative instruments is subject to SFAS 71, “Accounting for Certain Types of Regulation”. Therefore, the fair value of these derivatives is recorded as current or deferred assets and liabilities, with offsetting positions recorded as regulatory assets and regulatory liabilities on the Consolidated Balance Sheet. Gains or losses on the settlement of these contracts are initially deferred and then refunded to or collected from our firm gas sales customers consistent with regulatory requirements.

***Physically-Settled Commodity Derivative Instruments.*** Certain of our contracts for the physical purchase of natural gas and certain power supply contracts were assessed as no longer being exempt from the requirements of SFAS 133 as normal purchases. As such, these contracts are recorded on the Consolidated Balance Sheet at fair market value. However, since such contracts were executed for regulated utility customers, and pursuant to the requirements of SFAS 71, changes in the fair market value of these contracts are recorded as a regulatory asset or regulatory liability on the Consolidated Balance Sheet.

***Weather Derivatives.*** The utility tariffs associated with certain of our gas distribution operations do not contain weather normalization adjustments. As a result, fluctuations from normal weather may have a significant positive or negative effect on the results of these operations. To mitigate the effect of fluctuations from normal weather on our financial position and cash flows, we may enter into derivative instruments from time to time. Based on the terms of the contracts, we account for these instruments pursuant to the requirements of Emerging Issues Task Force (“EITF”) 99-2 “Accounting for Weather Derivatives.” In this regard, we account for weather derivatives using the “intrinsic value method” as set forth in such guidance.

***Interest Rate Derivative Instruments.*** We continually assess the cost relationship between fixed and variable rate debt. Consistent with our objective to minimize our cost of capital, we periodically enter into hedging transactions that effectively convert the terms of underlying debt obligations from fixed to variable or variable to fixed. Payments made or received on these derivative contracts are recognized as an adjustment to interest expense as incurred. Hedging transactions that effectively convert the terms of underlying debt obligations from fixed to variable are designated and accounted for as fair-value hedges pursuant to the requirements of SFAS 133. Hedging transactions that effectively convert the terms of underlying debt obligations from variable to fixed are considered cash flow hedges.

#### **14. Comprehensive Income**

Comprehensive income is the change in the equity of a company, not including those changes that result from shareholder transactions. While the primary component of comprehensive income is reported as net income or loss, the other components of comprehensive income relate to changes in SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Postretirement Plans,” deferred gains and losses associated with hedging activity, and unrealized gains and losses associated with certain investments held as available for sale (see Note D – “Accumulated Other Comprehensive Income (Loss)”).

#### **15. Recent Accounting Pronouncements**

In March 2008, the Financial Accounting Standards Board (FASB) issued SFAS 161 “Disclosures about Derivative Instruments and Hedging Activities.” This Statement amends and expands the disclosure requirements of SFAS 133 with the intent to provide users of financial statements with an enhanced understanding of (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedged items are accounted for; and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance and cash flows. This Statement requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses of derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. This Statement shall be effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. This Statement will have no impact on results of operations, financial position or cash flows, but will impact footnote disclosures.

In February 2007, the FASB issued SFAS 159 “The Fair Value Option for Financial Assets and Financial Liabilities.” This statement permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement requires a business entity to report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. An entity may decide whether to elect the fair value option for each eligible item on its election date, subject to certain requirements described in the statement. This statement shall be effective as of the beginning of each reporting entity’s first fiscal year that begins after November 15, 2007. The Company has not elected the fair value method.

In December 2007, the FASB issued SFAS 141R “Business Combinations.” The objective of SFAS 141R is to improve the relevance and comparability of the financial information that a reporting entity provides in its financial reports about a business combination and its effects. This Statement establishes principles and requirements for how the acquirer recognizes and measures the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in business combination; and determines what information to disclose. This Statement shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. This Statement has no impact on the Company’s current results of operations, cash flows or financial position.

In December 2007, the FASB issued SFAS 160 “Noncontrolling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin 51 “Consolidated Financial Statements.” The objective of SFAS 160 is to improve the relevance, comparability and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 shall be effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company is currently reviewing the requirements of SFAS 160, and at this point in time cannot determine what impact, if any, SFAS 160 will have on its results of operations, cash flows or financial position.

On September 15, 2006, the FASB issued SFAS 157 “Fair Value Measurements.” This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value. SFAS 157 expands the disclosures about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. The disclosures focus on the inputs used to measure fair value, the recurring fair value measurements using significant unobservable inputs and the effect of the measurement on earnings (or changes in net assets) for the period. The guidance in SFAS 157 also applies for derivatives and other financial instruments measured at fair value under Statement 133 “Accounting for Derivative Instruments and Hedging Activities” at initial recognition and in all subsequent periods. This Statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently reviewing the requirements of SFAS 157, and at this point in time cannot determine what impact, if any, SFAS 157 will have on its results of operations or financial position. This Statement will have no impact on cash flow.

## **16. Reclassifications**

Certain amounts from prior years have been reclassified on the accompanying consolidated financial statements to conform to the fiscal 2008 presentation.

In the fiscal year 2007 financial statements, the adoption of SFAS No. 158 was presented as activity during the fiscal year and therefore was included in comprehensive income (loss). However, it should have been reported as a direct reduction of accumulated other comprehensive income (loss) in the changes in equity accounts disclosed as an adjustment in the reporting period and excluded from comprehensive income (loss). The amount incorrectly recorded to comprehensive income (loss) was \$398 million. The March 31, 2007 accumulated other

comprehensive income (loss) balance reported in the fiscal year 2007 financial statements was properly stated. See Note D – “Accumulated Other Comprehensive Income (Loss)”.

### **17. Other Property and Investments**

Certain subsidiaries own as their principal assets, investments (including goodwill), representing ownership interests of 50% or less in energy-related businesses that are accounted for under the equity method. None of these current investments are publicly traded. Additionally, the Company has corporate assets recorded on the Consolidated Balance Sheet - other property and investments, representing funds designated for Supplemental Executive Retirement Plans. These funds are primarily invested in corporate owned life insurance policies. The Company records changes in the value of these assets in accordance with SFAS Technical Bulletin 85-4 “Accounting for the Purchase of Life Insurance.” As such, increases and decreases in the value of these assets are recorded through earnings in the Consolidated Statement of Income - other income and (deductions) concurrent with the change in the value of the underlying assets.

### **18. Pension and Other Postretirement benefits**

The Company adopted the provisions of SFAS 158 “Employers’ Accounting for Defined Benefit Pensions and Other Postretirement Benefit Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)” (SFAS 158) on March 31, 2007. SFAS 158 requires employers to fully recognize all postretirement plans funded status on the balance sheet as a net liability or asset and required an offsetting adjustment to accumulated other comprehensive income in shareholders’ equity upon implementation. As required by SFAS 158, the Company values its pension and other postretirement assets using the year-end market value of those assets. Benefit obligations are also measured at year-end. (See Note F “Employee Benefits” for additional details on the Company’s pension and other postretirement plans.)

## **NOTE B – RATE AND REGULATORY**

The Company’s regulated subsidiaries generally use the same accounting policies and practices for financial reporting purposes as non-regulated companies under US GAAP. However, actions by the FERC and the state utility commissions can result in accounting treatment that is different from that used by non-regulated companies. The Company applies the provisions of the SFAS No. 71, “Accounting for Certain Types of Regulation,” which requires regulated entities, in appropriate circumstances, to establish regulatory assets or liabilities, and thereby defer the income statement impact of certain charges or revenues because they are expected to be collected or refunded through future customer billings.

In the event the Company determines, as a result of lower than expected revenues and (or) higher than expected costs, that its net regulatory assets are not probable of recovery, it can no longer apply the principles of SFAS No. 71. Management believes its rates are based on the Company’s costs and investments and it should continue to apply the provisions of SFAS No. 71. The Company is earning a return on most of its regulatory assets under its rate agreement. If the Company could no longer apply SFAS No. 71, the resulting charge would be material to the Company’s reported financial condition and results of operations.

The following table details the various categories of miscellaneous regulatory assets and liabilities:

At March 31 (in millions)	2008	2007
<i>Regulatory assets included in accounts receivable:</i>		
Rate adjustment mechanisms	\$ 106.8	\$ 12.7
<i>Current portion of regulatory assets:</i>		
Derivative and swap contracts	76.3	264.5
Purchase power obligations	3.1	10.9
Pension and post-retirement benefit plans other than pension cost	39.6	-
Yankee nuclear decommissioning costs and environmental response fund	31.8	28.6
Other	54.1	-
	<b>204.9</b>	304.0
<i>Current portion of regulatory liabilities:</i>		
Derivative and swap contracts	(117.4)	-
Rate adjustment mechanisms	(140.2)	(129.3)
Other	(65.2)	-
	<b>(322.8)</b>	(129.3)
<b>Total net miscellaneous regulatory assets (liabilities) current</b>	<b>(11.1)</b>	187.4
<i>Regulatory assets:</i>		
Stranded costs	1,901.0	2,273.2
Purchase power obligations	116.4	119.9
Derivative and swap contracts	147.4	254.7
Regulatory tax asset	162.8	139.8
Deferred environmental restoration costs	1,500.2	633.6
Pension and post-retirement benefit plans other than pension cost	1,773.3	1,248.7
Yankee nuclear decommissioning costs	91.9	117.4
Loss on reacquired debt	61.5	69.2
Long-term portion of standard offer under-recovery	51.3	49.9
Other	162.5	195.0
	<b>5,968.3</b>	<b>5,101.4</b>
<i>Regulatory liabilities:</i>		
Stranded costs and CTC related	(131.2)	(125.1)
Pension and post-retirement plans fair value deferred gain	(385.7)	(266.5)
Interest saving deferral	(92.5)	(92.5)
Environmental response fund and insurance recoveries	(118.5)	(91.3)
Storm costs reserve	(44.1)	(45.6)
Other	(387.2)	(225.6)
	<b>(1,159.2)</b>	(846.6)
<b>Total net miscellaneous regulatory assets non-current</b>	<b>4,809.1</b>	4,254.8
<b>Net miscellaneous regulatory assets</b>	<b>\$ 4,798.0</b>	\$ 4,439.9

**Stranded costs:**

Certain regulatory assets, referred to as stranded costs, resulted from major fundamental changes occurring in the public utility industry, most notably the divestiture of generation assets pursuant to deregulation. Under deregulation, the generation segment of the utility business was opened to competition in that consumers could choose their generation supplier. Public utilities continued to control the transmission and distribution of electricity and were encouraged to dispose of generation assets such as power plants. The net unrecovered costs from the sale of these generation assets, along with the costs to terminate, restate or amend existing purchase

power contracts were deferred for recovery in rates over future periods. A large portion of these stranded costs are being recovered through a special rate being charged to customers. Similarly, the recovery of costs outside of customer rate recovery, but that nevertheless relate to the former generation business, are credited back to customers as well to offset stranded costs. This mechanism is called the Contract Termination Charge and (or) the Competitive Transition Charge (in both cases, these charges are called the CTC).

Management believes that future cash flows from charges for electric service under existing rate plans, including the CTC, will be sufficient to recover the Company's electric regulatory assets over the planned amortization period. This assumes that there will be no unforeseen reduction in demand and no bypass of the CTC or exit fees. In the event that revenues are lower than expected and (or) are higher than expected, the Company may determine that its net regulatory assets are not probable of recovery and that it can no longer apply the principles of SFAS No. 71. In that case, an after-tax, non-cash charge against income for any remaining unamortized regulatory assets and liabilities could be required. If the Company's subsidiaries could no longer apply SFAS No. 71, the resulting charge would be material to the Company's reported financial condition and results of operations.

#### **Rate Agreements:**

##### **NEP**

*New England Regional Transmission Organization (RTO) and Rate Filing:* On October 31, 2006, FERC issued an order establishing the return on common equity (ROE) for the New England Transmission Owners (NETOs), including NEP. In this order, FERC overturned the Administrative Law Judge's initial decision and approved, over the dissent of two Commissioners, the proposed 1.0 percent ROE adder for all new transmission investment approved through the regional system planning process as an incentive to build new transmission infrastructure. The resulting ROE varied depending on whether costs are recovered through Regional Network Service (RNS) rates or local network service (LNS) rates, and whether the costs are for existing or new facilities. For the locked-in period (February 2005 to October 2006), the resulting ROEs were 10.7 percent (including a 0.5 percent RTO participation adder) for recovery of existing transmission costs through RNS rates; 11.7 percent (including 0.5 percent and 1.0 percent adders) for new transmission costs recovered through RNS; and 10.2 percent (base ROE only) for LNS. For the prospective period beginning November 1, 2006, those ROEs increased to 11.4 percent, 12.4 percent and 10.9 percent respectively as a result of a FERC adjustment to reflect updated bond data. Overall, the ROEs approved by FERC represent an increase from NEP's last authorized ROE of 10.25 percent.

The NETOs and opposing parties to the NETOs requested rehearing of various aspects of the Commission's order. On March 24, 2008, FERC issued an order on rehearing increasing NEP's base ROE for all classes of transmission plant by 24 basis points retroactive to February 1, 2005. The Commission also limited the 1.0 percent ROE adder it had previously granted for new transmission investment approved under the regional system planning process so that it only applies to new transmission plant placed in service on or before December 31, 2008. The Commission's order also indicated that any future transmission investment incentives after 2008 must be sought through initiating an incentive proposal under Section 205 of the Federal Power Act pursuant to the Commission's Order No. 679 Transmission Pricing Policy.

## Niagara Mohawk

### *Deferral Audit:*

Under its Merger Rate Plan (MRP) Niagara Mohawk is authorized to recover actual amounts deferred under the plan for each two-year period, as well as deferrals projected to accrue over the subsequent two-year period that are in excess of a \$100 million threshold. The deferrals are subject to regulatory review and approval. On July 29, 2005, Niagara Mohawk made its biannual deferral account recovery filing for balances in the deferral account as of June 30, 2005 plus projected deferrals. The Staff of the NYPSC (the Staff) filed testimony on August 2, 2006, proposing in excess of \$200 million of initial adjustments to the deferral balance and projected deferrals. After replies from the Staff and Niagara Mohawk, an evidentiary hearing was held on October 5, 2006. Upon the conclusion of the evidentiary hearings, Niagara Mohawk and the Staff agreed to enter into non-binding mediation discussions before an administrative law judge from the NYPSC in an attempt to resolve some or all of the amounts remaining in dispute.

Through the mediation process, Niagara Mohawk, the Staff, and Multiple Intervenors (Parties), reached a resolution of the disputed issues presented in the deferral account case as well as other cases pending before the Commission regarding pension costs, the costs of enhanced inspections of the transmission and distribution system, and the sale of the Nine Mile Point nuclear generating facilities. A Stipulation of the Parties (Stipulation) setting forth the resolution of these issues was executed and filed with the Commission on March 23, 2007. A hearing on the Stipulation was held before the NYPSC's administrative law judge on May 17, 2007.

Under the Stipulation, Niagara Mohawk had agreed to a net reduction of the deferral account balance of approximately \$127 million. This includes reclassifications from the deferral account to other balance sheet accounts of approximately \$64 million. It also includes a reduction to the deferral account balance as of February 28, 2007 and decrease to earnings before income taxes of approximately \$63 million.

### *Third CTC reset and Deferral Account Filings:*

The biannual deferral account filing included in the third CTC reset was made on August 1, 2007 for deferral balances as of June 30, 2007 and projected deferrals through December 31, 2009. Any differences in the final deferral from balances authorized to be reflected in rates and the approved recovery level would be reflected in the next CTC reset filing and resulting rates to customers that take effect after 2009. A NYPSC order establishing the amount of deferral account recovery that will be reflected in the rates during 2008-2009 was approved on December 17, 2007 at \$124 million per calendar year. This represents a reduction in rates charged to customers of \$76 million per year from the \$200 million per year previously being collected under rates approved in the second CTC reset proceeding.

On October 22, 2007, Niagara Mohawk made a compliance filing with the NYPSC regarding the implementation of the Follow-on Merger Credit associated with the KeySpan Acquisition. In its compliance filing, Niagara Mohawk calculated the share of the KeySpan Follow-on Merger savings allocable to Niagara Mohawk for the period from September 2007 through December 2011 to be approximately \$40 million. Niagara Mohawk subsequently agreed, in its comments filed in the Third CTC Reset proceeding on October 31, 2007, to adjust rates submitted in its August 1, 2007 CTC Reset filing to reflect a proposal by the parties in that proceeding to accelerate the KeySpan Follow-on Merger Credit allocable to Niagara Mohawk's electric customers. This proposal was approved by the NYPSC in December 2007 and has resulted in a

credit being applied for the benefit of electric customers over the next two years equal to the net present value of the KeySpan Follow-on Merger Credit that otherwise would have been credited to Niagara Mohawk electric customers over the four remaining years of the MRP. On May 29, 2008, however, the PSC issued its decision with respect to Niagara Mohawk's October 22, 2007 compliance filing rejecting Niagara Mohawk's proposed amount and requiring a Follow-on Merger Credit of \$52 million for the August 24, 2007 through December 2011 period. Niagara Mohawk has submitted a letter to the NYPSC stating that it intends to seek rehearing of the order. The NYPSC has also issued a notice on June 25, 2008 seeking additional comment on two Follow-on Merger savings issues that were not addressed in the compliance filing. In the notice, the Commission asked for comments on a Staff position that Niagara Mohawk should be crediting an additional \$35 million of synergy savings to electric and gas customers. Niagara Mohawk disagrees with the Staff position. On June 30, 2008, Niagara Mohawk filed a petition for rehearing of the May 29, 2008 order from the NYPSC.

*Service Quality Penalties:*

In connection with its Merger Rate Plan (MRP), Niagara Mohawk is subject to maintaining certain service quality standards. Service quality measures focus on eleven categories including safety targets related to gas operations, electric reliability measures related to outages, residential and business customer satisfaction, meter reads, customer call response times, and administration of the Low-Income Customer Assistance Program. If a prescribed standard is not satisfied, Niagara Mohawk may incur a penalty, with the penalty amount applied as a credit or refund to customers.

The MRP includes provisions related to frequency and duration of outages that causes the annual \$4.4 million penalty associated with these standards to be doubled under certain circumstances when penalties have been incurred in the current year and two of the last four years. In calendar year 2006, Niagara Mohawk incurred a \$4.4 million penalty related to outage frequency, which it recorded in fiscal year 2007. Similar penalties were incurred in the two prior years. Based on this performance and consistent with the terms of the MRP, the NYPSC on November 7, 2007 doubled the 2006 penalty associated with outage frequency to \$8.8 million per year. In September 2007, the Commission also modified the MRP, in the context of the KeySpan Acquisition proceeding, to add an additional incremental \$4.4 million penalty exposure for each consecutive year Niagara Mohawk misses the target for a doubled penalty. This additional incremental penalty exposure resulted in a \$13.2 million penalty for missing the outage frequency target for 2007.

Niagara Mohawk has recorded service quality penalty expenses of \$14.2 million and \$10.9 million for the twelve months ended March 31, 2008 and 2007, respectively.

Niagara Mohawk filed with the NYPSC on October 26, 2007 to implement an automated outage management system and to recalibrate its targets relating to the frequency and duration of outages. The recalibration is intended to allow for a transition to the new outage management system in a performance neutral manner.

*Asset Condition and Capital Investment Plan:*

On October 22, 2007, Niagara Mohawk filed with the NYPSC reports on its asset condition and capital investment plan for its electric transmission and distribution system. Niagara Mohawk's plan involves significant investment in capital improvements over the projections initially

included in its MRP. In the order approving the KeySpan Acquisition, the NYPSC found that the rate impacts associated with certain incremental investments during the remaining period of the MRP would be limited to 50 percent of the total rate impact as ultimately determined by the NYPSC.

On December 21, 2007, Niagara Mohawk filed with the NYPSC a Petition for Special Ratemaking seeking authorization to defer for later rate recovery 50 percent of the revenue requirement impact during calendar year 2008 of specified capital programs and operating expenses that are directly associated with these programs. The amount of the requested deferral is projected to be approximately \$5.2 million in calendar year 2008. At a Commission meeting on July 16, 2008, the NYPSC agreed to adopt a staff recommendation finding that Niagara Mohawk's deferral request qualifies for deferral under the MRP. However, the Commission also agreed with the staff that the petition was premature and decided that Niagara Mohawk should supplement its petition with actual expense information once results for 2008 become known. Niagara Mohawk will be required to show in its supplemental filing that it will not over earn in 2008 after the deferrals are allowed, the expenditure on which the deferrals are based on incremental to what was reflected in the MRP forecast, such expenditures have been offset by all relevant cost savings and related benefits, and to the extent that actual expenditures for 2008 differ from amounts in the budgets that were previously filed with the Commission, that Niagara Mohawk identify and explain the basis for such differences. Niagara Mohawk plans to request deferral recovery of 50 percent or more of the annual revenue requirement associated with certain capital investments and associated operating expenses through the end of 2011 at a later date.

*Financial Protections:*

Niagara Mohawk made a filing on November 19, 2007 proposing certain financial protections for Niagara Mohawk as required by the NYPSC in the order approving the KeySpan Acquisition and made an additional filing with the NYPSC regarding these protections. The NYPSC adopted the protections in March 2008 which provide, among other things, for restrictions on the payment of common dividends if certain credit ratings are not maintained by Niagara Mohawk or National Grid plc; credits to Niagara Mohawk's deferral account of any incremental increase in interest expense due to a decline in Niagara Mohawk's bond rating; a prohibition with respect to certain types of cross-default provisions; and the implementation of a class of preferred stock having one share (the Golden Share), subordinate to any existing preferred stock, that would have voting rights which limit Niagara Mohawk's right to commence any voluntary bankruptcy, liquidation, receivership or similar proceeding without the consent of such share of stock. Niagara Mohawk committed to seek authority from the NYPSC to establish the Golden Share within six weeks of the NYPSC's approval of the petition of KEDNY and KEDLI for the establishment of each of their respective Golden Shares which was also required by the NYPSC.

On January 31, 2008, Moody's Investors Service said it has changed the outlook for National Grid plc and its subsidiaries, including Niagara Mohawk, to negative from stable following National Grid plc's announcement that it will increase its dividend for 2007-08 by 15 percent.

## **Rate Plan Filing:**

### **Niagara Mohawk**

Niagara Mohawk filed with the PSC on May 23, 2008 for a \$95 million rate increase in natural gas delivery rates. This filing would represent the first delivery rate increase since 1996. The filing includes a revenue decoupling proposal, a gas marketing program, a new rate for low-income customers and expanded capital infrastructure investments. The proposed \$95 million rate increase would include recovery of \$11 million of costs associated with an energy efficiency program proposal filed recently. The filing further reflects an 11 percent return on equity and a 50 percent debt and 50 percent equity capital structure. A decision is expected by the NYPSC in May 2009 at which point new rates would become effective, if approved.

### **The Narragansett Electric Company**

**Electric segment:** In September 2004, the Rhode Island Public Utility Commission approved a rate plan that reduced annual distribution rates effective November 1, 2004 by \$10.2 million and froze them at that level through 2009. From 2005 through 2009, the Company will keep 100 percent of its earnings up to an allowed return on equity of 10.5 percent, plus \$4.65 million (pre-tax), which represents its share of demonstrated savings under the rate plan. Earnings above that amount up to an 11.5 percent return on equity are to be shared equally between the Company and its customers, while earnings above an 11.5 percent return on equity will be allocated 75 percent to customers and 25 percent to the Company.

**Gas segment:** In fiscal year 2007 (August 2006), National Grid completed the acquisition of the Rhode Island gas assets of New England Gas Company. Pursuant to the Rhode Island Public Utility Commission order approving the acquisition, Narragansett and its parent agreed to honor the provisions of the former New England Gas Company Rate Settlement and committed to file a new rate plan with the Rhode Island Public Utility Commission. On April 1, 2008, Narragansett submitted its new rate plan which included, among other things, a requested \$20 million increase in distribution rates, including a return on equity of 11.50 percent, and proposals for revenue decoupling, an accelerated capital investment and recovery mechanism, low income distribution rates and sharing of merger related savings between customers and Narragansett. The submission also included an alternative three year rate plan which replaces the initial \$20 million rate increase with annual increases of \$13.8 million in each of the three years of the plan and includes other capital investment commitments by the Company. A decision on the April 1<sup>st</sup> submission is expected in the third quarter of fiscal year 2009.

### **KeySpan**

On August 22, 2007, the NYPSC unanimously voted to approve the KeySpan Acquisition by National Grid plc. The NYPSC issued an abbreviated order and a long-form order on August 23, 2007 and September 17, 2007, respectively, authorizing the KeySpan Acquisition subject to conditions and setting partial revenue requirements for KEDNY and KEDLI (“the Order”). In addition, KEDNY and KEDLI reached an agreement in principle with the Staff of the NYPSC and other parties related to gas rates for KEDNY and KEDLI and on October 10, 2007 the Gas Rates Joint Proposal (“the Rates JP”) was filed with the NYPSC for approval. The Rates JP was approved at the NYPSC session on December 21, 2007. Below is a discussion of the more significant aspects of the Order and the Rates JP.

### *The Order*

The Order sets out conditions for the KeySpan Acquisition, upon which the NYPSC's approval is based. These conditions, relate to, among other things, financial protections for customers; potential revenue adjustments that are based on safety, reliability and customer service performance measures; and requirements concerning the sale of the Ravenswood Generating Station. The Order also makes some revenue requirement determinations for KEDNY and KEDLI that are discussed more fully below.

The Order includes the following restrictions and/or requirements that KEDNY and KEDLI must adhere to.

1. Goodwill, or the amount National Grid plc pays for KeySpan Corporation (together with transaction costs) in excess of the book value of the assets and liabilities of the latter and its subsidiaries, will not be reflected on the regulatory books of KEDNY or KEDLI or in the determination of KEDNY and KEDLI's rates and the calculation of their respective earned returns.
2. KEDNY and KEDLI will each be able to pay dividends in any year, provided at least two nationally and internationally recognized rating agencies give it an investment grade credit rating. The maximum dividend in any year would be (a) income available for dividends in that year, plus (b) cumulative retained earnings, plus (c) certain paid in capital.
3. KEDNY and KEDLI will each be barred from paying dividends when (a) its least secure form of debt is at the lowest investment grade and at least one rating agency has issued an outstanding negative watch or review downgrade notices, or (b) National Grid plc's least secure form of debt is rated below investment grade by one or more rating agencies.
4. If KEDNY's and KEDLI's bond rating falls below A- or A3, as determined by two nationally recognized credit rating agencies, then any long-term debt issued by the relevant company during the period of such reduced credit rating will be priced as if it had been issued by an A-/A3 utility at the same issue date, and any difference will be credited to KEDNY's or KEDLI's customers. KEDNY's and KEDLI's earnings sharing calculations will then reflect the actual debt rates outstanding for the companies.
5. KEDNY's and KEDLI's debt ratios for any 12-month period ending at the end of a fiscal quarter will not exceed 56% and 58%, respectively. If these limits are exceeded, KEDNY and KEDLI would have a nine month period to reduce their debt balance accordingly, during which the dividends paid out as a percentage of total equity may not be increased. If the stated debt ratios are not met by the end of the nine month cure period, KEDNY and/or KEDLI may not pay any dividends until the debt limits are met.
6. No debt associated with the KeySpan Acquisition will be reflected as an obligation of KEDNY or KEDLI.

7. There will be a regulated money pool in which KEDNY and KEDLI may participate as borrowers and lenders. The regulated money pool will prohibit its utility participants from directly or indirectly loaning or transferring funds borrowed from the regulated money pool to any unregulated affiliate.
8. There will be no cross-default provisions for any affiliate of National Grid plc that affect KEDNY and KEDLI.
9. KEDNY and KEDLI will establish “golden shares” to prevent a bankruptcy of any National Grid plc affiliate from necessarily triggering a bankruptcy of KEDNY and KEDLI. The holder(s) of the golden shares will be determined by the NYPSC.

In addition to the above, KEDNY and KEDLI are subject to maintaining certain service quality and reliability performance standards. KEDNY’s or KEDLI’s failure to meet the stated performance targets for calendar years 2008 through 2012 may result in downward revenue adjustments. The safety and reliability performance measures focus primarily on (i) minimum requirements for main and service replacement; (ii) response time for gas leak investigations; and (iii) reduction in the number of gas leaks. Failure to meet the safety and reliability performance measures can result in downward revenue adjustments of up to \$7.0 million and \$6.2 million for KEDNY and KEDLI, respectively. The customer services performance measures focus primarily on (i) reducing the number of customer complaints and customer bill adjustments; (ii) customer survey satisfaction ratings; and (iii) response time associated with customer telephone inquires. Failure to meet the customer service performance measures can result in downward revenue adjustments of up to \$11.7 million and \$9.9 million for KEDNY and KEDLI, respectively.

National Grid plc is also required, as a condition to NYPSC approval, to sell the Ravenswood Generating Station within the next three years. KeySpan has announced that it has agreed to sell KeySpan Ravenswood, LLC to TransCanada and expects to complete the transaction during the summer of 2008. Additionally, National Grid plc took steps to assure that it is financially indifferent to the price of energy in the New York City electric energy market with respect to the electric output of the Ravenswood Generating Station by entering into a single contract on January 1, 2008 to sell all the Ravenswood Generating Station’s energy for the period prior to the divestiture of the Ravenswood Generating Station. Capacity and ancillary services from the Ravenswood Generating Station will continue to be bid into the market. However, commencing with the New York Independent System Operator auction for 2008, capacity for the Ravenswood Generating Station must be bid at zero or an agreed to level based solely on the marginal cost to maintain the plant in service.

#### *The Gas Rates Joint Proposal*

As noted, KEDNY and KEDLI reached an agreement with the NYPSC and other parties related to gas rates for KEDNY and KEDLI. The discussion that follows summarizes some of the more significant aspects to the Rate JP.

Under the Rates JP, KEDNY’s base delivery rates will be increased \$5 million annually in rate year one (beginning January 1, 2008) through rate year five. However, the increase in base delivery rates will be deferred and used to offset future increases in special franchise taxes and

environmental investigation and remediation costs. KEDLI's base delivery rates will be increased by \$60 million on January 1, 2008. In rate years two through five, base delivery rates for KEDLI will be increased \$10 million. However, the increase in KEDLI's base delivery rates will also be deferred and used to offset future increases in special franchise taxes and environmental investigation and remediation costs. In addition, for both KEDNY and KEDLI, certain gas related costs previously recovered in base delivery rates were transferred out of base delivery rates on January 1, 2008 and are currently being recovered through the gas adjustment clause. The calculation of the revenue requirement for each company reflects a 50% - 50% sharing of net synergy savings (synergy savings less costs to achieve those synergy savings) that are estimated to be generated as a result of the merger.

As part of the Rates JP, KEDNY returned to the New York Public Service Commission's Statement of Policy for Pensions and Other Postretirement Employee Benefits (OPEB) issued in September 1993. As a result, KEDNY will reconcile its actual pension and OPEB expense to the estimated pension and OPEB expense established in the Rates JP and defer or "true-up" the difference for future recovery from or refund to its gas sales customers. KEDNY recorded a regulatory liability of approximately \$128 million to return to the Statement of Policy for Pensions and Other Postretirement Employee Benefits along with a direct charge to equity. The regulatory liability will be amortized over the next five years. KEDLI has followed the Statement of Policy for Pensions and Other Postretirement Employee Benefits since it was issued.

The Rates JP also allows KEDNY to true-up 90% of the difference between actual property and special franchise taxes to the estimated amounts established in the Rates JP. However, recovery of \$22.5 million of previously deferred special franchise taxes was disallowed and expensed. KEDLI is currently following this procedure. KEDLI, however, was required to record a \$62 million regulatory liability associated with a Nassau County property tax litigation matter. This amount was recorded as a direct charge to equity and the regulatory liability will be amortized over five years. Additionally, both companies are permitted to continue to true-up 100% of the difference between actual environmental site and investigation costs to the estimated amounts established in the Rates JP.

The revenue requirement for both companies provide for sharing of earnings above 10.5% calculated using an equity component of 45% with gas sales customers in the following manner. Earnings between 10.5% - 12.5% are shared 50% - 50% between gas sales customers and KEDNY and KEDLI. Earnings between 12.5% - 13.5% are shared 65% to gas sales customers and the remaining 35% to KEDNY and KEDLI. Earnings in excess of 13.5% are refunded to gas sales customers.

Additionally, certain "exogenous costs" that are outside the control of KEDNY and KEDLI, may be deferred for future recovery from or refund to gas sales customers. Exogenous costs are incremental effects on KEDNY's and KEDLI's revenue requirements due to any of the following: (i) externally imposed accounting changes; (ii) any change in Federal, state or local taxes; and (iii) any legislative, court or regulatory change

Also as part of the Rates JP, the temperature controlled monthly price cap that can be charged to large volume dual-fuel temperature controlled customers was changed to an annual price cap. In our large-volume heating and other interruptible (non-firm) markets, which include large

apartment houses, government buildings and schools, gas service is provided under rates that are designed to compete with prices of alternative fuel, including No. 2 and No. 6 grade heating oil. These “dual-fuel” customers can consume either natural gas or fuel oil for heating purposes. Also, based on NYPSC regulations, gas sales to some of these customers may be interrupted when the temperature falls below 15 degrees to ensure system reliability to firm gas sales customers. Under the new mechanism, effective January 1, 2008, temperature controlled prices, including the minimum charge, are subject to an annual price cap based on the commercial heating rate paid by firm gas sale customers. The Company estimates that this pricing change, under certain circumstances, could reduce consolidated earnings by \$12 million.

#### *Other Matters*

On February 23, 2008, EnergyNorth Natural Gas, Inc. d/b/a/ National Grid NH filed a request with the New Hampshire Public Utilities Commission to increase distribution rates by approximately \$9.9 million for its approximately 84,000 New Hampshire natural gas customers. The requested increase reflects an overall rate of return of 9.26% based on an 11.5% return on common equity and a 50/50 imputed capital structure as stipulated in the Merger Settlement Agreement and approved in Docket DG 06-122.

Contemporaneous with the request for permanent rates, the Company also filed a request for temporary rates designed to produce a temporary rate increase of approximately \$6.6 million in annual revenues to be effective with service rendered on and after August 24, 2008 and remain in effect until a determination of the Company’s request for permanent rates. The EnergyNorth Merger Rate Agreement, which was approved by the Commission in Order No. 24,277 in Docket DG 06-107 as part of its authorization of the KeySpan Acquisition, contemplated that the Company would file for a temporary rate increase with rates to be effective one year after consummation of the merger (i.e., August 24, 2008). Any temporary rate increase approved by the Commission would be subject to reconciliation with the final rates established by the Commission retroactive to August 24.

#### **NOTE C – COMMITMENTS AND CONTINGENCIES**

The normal ongoing operations and historic activities of the Company are subject to various federal, state and local environmental laws and regulations. Like most other industrial companies, the Company’s historic and current gas, electric transmission and distribution and electric generation businesses use or generate some hazardous and potentially hazardous wastes and by-products. Under federal and state Superfund laws, potential liability for the historic contamination of property may be imposed on responsible parties jointly and severally, without fault, even if the activities were lawful when they occurred.

**Air.** Our generating facilities are located within a Clean Air Act (CAA) ozone non-attainment and PM 2.5 (fine particulate matter) non-attainment area, and are likely to be subject to increasingly stringent NO<sub>x</sub>, SO<sub>2</sub> and particulate emission limitations. While regulatory programs to implement such limitations are the subject of various federal legal proceedings, the Company is implementing strategies to achieve various improvements. These improvements also include measures to improve fuel efficiency and reduce CO<sub>2</sub> emissions and are planned to be incurred over a five to six year period and are estimated to cost approximately \$100 million. Such amounts are substantially recoverable through contractual provisions with LIPA.

**Water.** Additional capital expenditures associated with the compliance and renewal of the surface water discharge permits for our power plants will likely be required by the Department of Environmental Conservation (DEC). Such amounts, estimated to be approximately \$60 million over the next ten years, are recoverable through contractual provisions with LIPA.

**Land, Manufactured Gas Plants and Related Facilities.** Federal and state environmental regulators, as well as private parties, have alleged that several of the Company's subsidiaries are potentially responsible parties under Superfund laws for the remediation of over 200 contaminated sites in New England, New York and Rhode Island. The Company's greatest potential Superfund liabilities relate to manufactured gas plant, or MGP, facilities formerly owned or operated by the Company's subsidiaries or their predecessors. MGP byproducts included fuel oils, hydrocarbons, coal tar, purifier waste and other waste products that may pose a risk to human health and the environment. The Company is investigating or remediating these sites, or both, as appropriate.

The Company uses the "Expected Value" method for measuring its environmental liabilities. The Expected Value method applies a weighting to potential future expenditures based on the probability of these costs being incurred. A liability is recognized for all potential costs based on this probability. Costs considered to be 100% probable of being incurred are recognized in full, with costs below a 100% probability recognized in proportion to their probability. As required by SFAS 141, KeySpan discounted its environmental reserves at the time of acquisition using an appropriate fair value methodology. Adjustments to the environmental reserves based on changing circumstances will be undiscounted. Environmental reserves recorded prior to the KeySpan Acquisition for non-KeySpan companies have not been discounted.

The Company's total reserve for estimated MGP related environmental activities is approximately \$1.3 billion. The potential high end of the range at March 31, 2008 is presently estimated at approximately \$1.9 billion on an undiscounted basis. Management believes that obligations imposed on the Company because of the environmental laws will not have a material adverse effect on its operations, financial condition or cash flows. Through various rate orders issued by the NYPS, MADPU, NHPUC and Rhode Island PUC costs related to MGP environmental cleanup activities are recovered in rates charged to gas distribution customers. Accordingly, the Company has reflected a regulatory asset of \$1.5 billion.

The Company is pursuing claims against other potentially responsible parties to recover investigation and remediation costs it believes are the obligations of those parties. The Company cannot predict the likelihood of success of such claims.

**Non-Utility Sites:** The Company is aware of three non-utility sites for which it may have or share environmental remediation or ongoing maintenance responsibility. The Company presently estimates the remaining cost of the environmental cleanup activities for these three non-utility sites will be approximately \$23.2 million, which amount has been accrued as a reasonable estimate of probable costs for known sites however, remediation costs for each site may be materially higher than noted, depending upon changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered.

The Company believes that in the aggregate, the accrued liability for the sites and related facilities identified above are reasonable estimates of the probable cost for the investigation and

remediation of these sites and facilities. As circumstances warrant, we periodically re-evaluate the accrued liabilities associated with MGP sites and related facilities. We may be required to investigate and, if necessary, remediate each site previously noted, or other currently unknown former sites and related facility sites, the cost of which is not presently determinable.

**Decommissioning Nuclear Units:**

NEP has minority interests in three nuclear generating companies: Yankee Atomic Electric Company (Yankee Atomic), Connecticut Yankee Atomic Power Company (Connecticut Yankee), and Maine Yankee Atomic Power Company (Maine Yankee) (together, the Yankees). These ownership interests are accounted for on the equity method. The Yankees operated nuclear generating units that have been permanently retired. Physical decommissioning of the units is complete. Spent nuclear fuel remains on each site, awaiting fulfillment by the U.S. Department of Energy (DOE) of its statutory obligation to remove it. In addition, groundwater monitoring is ongoing at each site. The three units are as follows:

Unit	The Company's Investment at March 31, 2008		Date Retired	Future Estimated Billings to the Company	
	(percent)	(In millions)		(In millions)	
Yankee Atomic	34.5	\$ 0.5	Feb-92	\$	27.4
Connecticut Yankee	19.5	\$ 2.4	Dec-96	\$	67.0
Maine Yankee	24	\$ 0.5	Aug-97	\$	20.8

With respect to each of the units, NEP recorded a liability and a regulatory asset reflecting the estimated future decommissioning billings from the Yankees. In a 1993 decision, the FERC allowed Yankee Atomic to recover its undepreciated investment in the plant, including a return on that investment, as well as unfunded nuclear decommissioning costs and other costs. Maine Yankee and Connecticut Yankee recover their prudently incurred costs, including a return, in accordance with settlement agreements approved by the FERC in May 1999 and July 2000, respectively. The Yankees collect the approved costs from their purchasers, including NEP. NEP's share of the decommissioning costs is accounted for in "Purchased electric energy" on the income statement. Under settlement agreements, NEP is permitted to recover prudently incurred decommissioning costs through contract termination charges.

The Yankees are periodically required to file rate cases for FERC approval, which present the Yankees' estimated future decommissioning costs. The Yankees are currently collecting decommissioning and other costs under FERC Orders issued in their respective rate cases.

Future billings from the Yankees are based on cost estimates. These estimates include the projected costs of groundwater monitoring, security, liability and property insurance and other costs. They also include costs for interim spent fuel storage facilities, which the Yankees have constructed during litigation they brought to enforce the DOE's obligation to remove the fuel as required by the Nuclear Waste Policy Act of 1982. Following a trial at the U.S. Court of Federal Claims (Claims Court) to determine the level of damages, on October 6, 2006, the Claims Court awarded the three companies approximately \$143 million for spent fuel storage costs that had been incurred through 2001 and 2002. The Yankees had requested \$176 million. On December

4, 2006, the DOE filed a notice of appeal with the U. S. Court of Appeals for the Federal Circuit. Oral arguments were held on February 4, 2008. A decision is expected in 2008. If the order is upheld, the damages received by the Yankees, net of litigation expenses and taxes, will be applied to reduce the decommissioning and other costs collected from their purchasers. On December 14, 2007, the Yankees brought further litigation in the Claims Court to recover damages incurred subsequent to 2001 and 2002. DOE does not anticipate having a long term storage facility available to accommodate spent fuel for at least a decade. The decommissioning costs that are actually incurred by the Yankees may exceed the estimated amounts, perhaps substantially.

**Connecticut Yankee rate filing, prudence challenge and other proceedings:**

On July 1, 2004, Connecticut Yankee asked FERC for a rate increase to reflect increased costs for decommissioning, pensions and other employment benefits, increased security and insurance costs and other expenses. In aggregate, the increase requested amounted to approximately \$396 million through 2010. NEP's share is included in the future estimated billings shown in the preceding table. On November 16, 2006, FERC issued an Order approving a settlement reached by parties to the proceeding. Under the settlement, as a result of the operation of a budget incentive mechanism established in a prior rate settlement, NEP was not allowed to recover \$1 million of its expenditures.

The settlement provides that Connecticut Yankee may resume payment of dividends to return equity to sponsors. After January 1, 2008, Connecticut Yankee will not be allowed to earn a return on equity greater than \$10 million.

**Nuclear Contingencies:**

As of March 31, 2008 and 2007, the Company has a liability of \$165 million and \$158 million, respectively, in non-current liabilities for the disposal of nuclear fuel irradiated prior to 1983 at Niagara Mohawk's former nuclear facilities. In January 1983, the Nuclear Waste Policy Act of 1982 (the Nuclear Waste Act) established a cost of \$.001 per kWh of net generation for current disposal of nuclear fuel and provides for a determination of the Company's liability to the DOE for the disposal of nuclear fuel irradiated prior to 1983. The Nuclear Waste Act also provides three payment options for liquidating such liability and the Company has elected to delay payment, with interest, until the year in which Constellation Energy Group Inc., which purchased the Niagara Mohawk's nuclear assets, initially plans to ship irradiated fuel to an approved DOE disposal facility. Progress in developing the DOE facility has been slow and it is anticipated that the DOE facility will not be ready to accept deliveries until at least 2010.

**Long-Term Contracts for the Purchase of Electric Power:**

The Company's subsidiaries have several types of long-term contracts for the purchase of electric power. Substantially all of these contracts require power to be delivered before the Company is obligated to make payment. The Company's commitments under these long-term contracts, as of March 31, 2008, are summarized in the table below.

<i>(In millions of dollars)</i>	
Fiscal Years Ended March 31,	Estimated Payments
2009	\$ 2,347.3
2010	1,067.9
2011	368.7
2012	331.0
2013	234.9
Thereafter	2,268.9
<b>Total</b>	<b>\$ 6,618.7</b>

The Company's subsidiaries can purchase additional energy to meet load requirements from other independent power producers (IPPs), other utilities, energy merchants or on the open market through the New York Independent System Operator (NYISO) or the ISO-NE at market prices.

**Gas Supply, Storage and Pipeline Commitments:**

The Company's gas distribution subsidiaries have entered into various contracts for gas delivery, storage and supply services. Certain of these contracts require payment of annual demand charges in the aggregate amount of approximately \$975 million. The Company and its gas distribution subsidiaries are liable for these payments regardless of the level of services required from third parties. Such charges are currently recovered from utility customers as gas costs.

**Plant Expenditures:**

The Company's utility plant expenditures are estimated to be approximately \$1.4 billion in fiscal 2009. At March 31, 2008, substantial commitments had been made relative to future planned expenditures. Generally construction expenditure levels are consistent from year to year. However, the Company has undertaken a Reliability Enhancement Program to improve performance and reliability.

**Legal Matters:**

From time to time we are subject to various legal proceedings arising out of the ordinary course of our business. Except as described below, we do not consider any of such proceedings to be material to our business or likely to result in a material adverse effect on our results of operations, financial condition or cash flows.

From 1983 until 1998, NEP was the wholesale power supplier for Norwood, Massachusetts. In April 1998, Norwood began taking power from another supplier, although its contract term with NEP ran to 2008. Pursuant to a tariff amendment approved by the FERC in May 1998, NEP has charged Norwood a monthly contract termination charge (CTC) of \$0.6 million, plus interest on unpaid balances at 18 percent per year. NEP and Norwood have been engaged in litigation at the FERC and in the Massachusetts state court, as follows.

On December 20, 2003, Norwood filed a complaint with FERC under Section 206 of the Federal Power Act, contending that FERC did not approve the application of NEP's 1998 amended CTC to Norwood, and that the CTC amount is too high in any event. The FERC held that it did approve the CTC and that the CTC amount is correctly calculated and the First Circuit upheld

FERC, and the US Supreme Court denied Norwood's petition for certiorari. However, FERC ruled on May 17, 2007 that the interest to be paid by Norwood on unpaid monthly CTC bills should be calculated at the prime rate from the beginning of the CTC and not at 18 percent, as provided in the tariff. NEP appealed this interest ruling to the First Circuit on the ground that it goes beyond FERC's authority to award retroactive relief under Section 206 of the Federal Power Act, and violates the filed rate doctrine. Oral argument was held in April 2008, and the parties await a decision. In 1998, NEP filed a collection action in Massachusetts Superior Court (Worcester County) to collect the CTC from Norwood. In June 2004, NEP obtained a judgment from the Superior Court based on amounts owed through January 31, 2001. The Massachusetts appellate courts sustained NEP's judgment against several challenges by Norwood. However, state court proceedings have been stayed pending the outcome of the FERC and First Circuit proceedings described above. At this point, the remaining issue to be decided by the First Circuit is NEP's challenge to FERC's determination of the amount of late payment interest owed to NEP. To date, Norwood has paid NEP \$93.4 million, including its last payment of approximately \$53.2 million made in January 2008.

Narragansett is in litigation with Constellation Energy Commodities Group (Constellation) in two cases. In the first case commenced on September 11, 2006 in the U.S. District Court for the District of Rhode Island, Constellation has alleged that certain power purchase agreements entitle it to additional compensation for capacity during calendar years 2006-2009, following the FERC-approved settlement in the forward capacity market. According to Constellation, the resolution of this claim "could adversely affect Constellation in amounts upwards of \$150 million." In the second case commenced on April 14, 2008 in the U.S. District Court for the District of Massachusetts, Constellation has alleged that certain power purchase agreements entitle it to payments for a fuel adjustment factor during calendar years 2005-2009. The prospective portion of the fuel adjustment claim is subject to the effects of changing fuel prices. By Constellation's methodology for payment calculation, it is estimated that damages could exceed \$200 million. Narragansett is exploring its options to resolve these matters. Regardless of the outcome, Narragansett is entitled to recover all purchased power costs from customers under current law and legal precedent, however any request to recover increased costs that may result from resolution of these matters would be subject to approval by the Rhode Island Public Utility Commission.

Since July 12, 2006, eight lawsuits have been filed which allege damages resulting from contamination associated with the historic operations of former manufactured gas plants located in Bay Shore. KeySpan has been conducting site investigations and remediations at these locations pursuant to Administrative Orders on Consent (ACO) with the New York State Department of Environmental Conservation (DEC). One of these lawsuits was settled on May 15, 2008 by purchasing a residential property. There is one lawsuit pending related to the former Clifton manufactured gas plant on Staten Island. KeySpan intends to contest each of the remaining proceedings vigorously.

On February 8, 2007, KeySpan received a Notice of Intent to File Suit from the Office of the Attorney General for the State of New York (AG) against KeySpan and four other companies in connection with the cleanup of historical contamination found in certain lands located in Greenpoint, Brooklyn and in an adjoining waterway. KeySpan has previously agreed to remediate portions of the properties referenced in this notice and will work cooperatively with the DEC and AG to address environmental conditions associated with the remainder of the

properties. KeySpan has entered into an ACO for one of the land-based sites and is currently negotiating the terms of another ACO for the remaining land-based sites. To resolve issues associated with the waterway, KeySpan and the other four companies are currently negotiating the terms of a Consent Decree. At this time, we are unable to predict what effect, if any, the outcome of these proceedings will have on our financial condition, results of operation and cash flows.

In May 2007, KeySpan received a Civil Investigative Demand (CID) from the United States Department of Justice, Antitrust Division, requesting the production of documents and information relating to its investigation of competitive issues in the New York City electric energy capacity market prior to National Grid's acquisition of KeySpan. The CID is a request for information in the course of an investigation and does not constitute the commencement of legal proceedings, and no specific allegations have been made against KeySpan. In April 2008, KeySpan received a second CID in connection with this matter. KeySpan continues to believe that its activity in the capacity market is consistent with all applicable laws and regulations and will continue to fully cooperate with this investigation.

#### **Lease Obligations:**

The Company has various operating leases which include the lease of the Company's Brooklyn headquarters, a leveraged lease financing arrangement (as discussed below), as well as leases for other buildings, office equipment, vehicles and power operating equipment. Cash lease payments under these leases total approximately \$170 million a year.

#### *Sale/leaseback Transaction*

The Company has a leveraged lease financing arrangement associated with the Ravenswood Expansion. In May 2004, the unit was acquired by a lessor from our subsidiary, KeySpan Ravenswood, LLC, and simultaneously leased back to that subsidiary. All the obligations of KeySpan Ravenswood, LLC have been unconditionally guaranteed by KeySpan. This lease transaction qualifies as an operating lease under SFAS 98 "Accounting for Leases: Sale/Leaseback Transactions Involving Real Estate; Sales-Type Leases of Real Estate; Definition of the Lease Term; an Initial Direct Costs of Direct Financing Leases, an amendment of FASB Statements No.13, 66, 91 and a rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11." We have agreed to sell KeySpan Ravenswood, LLC to TransCanada Facility USA, Inc., a wholly owned subsidiary of TransCanada Corporation. The transaction provides for the restructuring and transfer of KeySpan's interest in the Ravenswood Expansion. TransCanada will prepay this sublease and provide back-to-back guarantees. However, KeySpan will remain responsible for the lease payments under this arrangement through the maturity of the lease – May 2040.

National Grid USA Service Company, Inc. entered into a lease dated January 7, 2008, in connection with an office building that will be newly constructed in Waltham, Massachusetts. The terms of the lease provide for a commencement date ("Commencement Date") to be set upon the substantial completion of the building, including all tenant improvements. The Commencement Date is currently projected to be May 15, 2009. The term of the lease expires twenty years and five months after the Commencement Date. The base rent under the lease increases every five years and will range between \$10 million and \$13 million annually.

*Variable Interest Entity*

We have an arrangement with an unaffiliated variable interest financing entity through which we lease a portion of the Ravenswood Facility. KeySpan acquired the Ravenswood Facility, in part, through the variable interest entity, from the Consolidated Edison Company of New York (“Consolidated Edison”) on June 18, 1999 for approximately \$597 million. In order to reduce the initial cash requirements, KeySpan entered into a lease agreement (the “Master Lease”) with the variable interest entity that acquired a portion of the facility, i.e. the three steam generating units, directly from Consolidated Edison and leased it to a KeySpan subsidiary. The variable interest financing entity acquired the property for \$425 million, financed with debt of \$412.3 million (97% of capitalization) and equity of \$12.7 million (3% of capitalization). KeySpan has no ownership interests in the units or the variable interest entity. KeySpan has guaranteed all payment and performance obligations of our subsidiary under the Master Lease. Monthly lease payments are substantially equal to the monthly interest expense on the debt securities.

The Master Lease had been consolidated on the Consolidated Balance Sheet based on KeySpan’s current status as primary beneficiary as defined in Financial Accounting Standards Board Interpretation No. 46 (FIN 46), “Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51.” As part of the process to sell KeySpan Ravenswood, LLC, KeySpan terminated the Master Lease in June 2008 at a cost of \$456 million. The operations of the Ravenswood Facility except for interest expense is classified as discontinued operations on the Consolidated Statement of Income, Consolidated Balance Sheet and Consolidated Statement of Cash Flows.

**Financial Guarantees:**

The Company has guaranteed the principal and interest payments on certain outstanding debt as discussed in Note H, “Long Term Debt”. Additionally, KeySpan has issued financial guarantees in the normal course of business, on behalf of its and the Company’s subsidiaries, to various third party creditors. At March 31, 2008, the following amounts would have to be paid by KeySpan in the event of non-payment by the primary obligor at the time payment is due:

<i>Nature of Guarantee (In Millions of Dollars)</i>		Amount of Exposure	Expiration Dates
<b>Guarantees for Subsidiaries</b>			
Medium-Term Notes - KEDLI	(i)	\$ 400.0	2010
Industrial Development Revenue Bonds	(ii)	128.3	2027
Ravenswood - Master Lease	(iii)	425.0	2009
Ravenswood - Sale/leaseback	(iv)	431.0	2040
Surety Bonds	(v)	72.9	Revolving
Commodity Guarantees and Other	(vi)	27.7	2008 - 2009
Letters of Credit	(vii)	76.7	2008 - 2011
		<b>\$ 1,561.6</b>	

The following is a description of KeySpan’s outstanding subsidiary guarantees:

- (i) KeySpan has fully and unconditionally guaranteed \$400 million to holders of Medium-Term Notes issued by KEDLI. These notes are due to be repaid February 1, 2010. KEDLI is required to comply with certain financial covenants under the debt

agreements. The face value of these notes is included in long-term debt on the Consolidated Balance Sheet.

- (ii) KeySpan has fully and unconditionally guaranteed the payment obligations of its subsidiaries with regard to \$128.3 million of Industrial Development Revenue Bonds issued through the Nassau County and Suffolk County Industrial Development Authorities for the construction of two electric-generation peaking plants on Long Island. The face value of these notes are included in long-term debt on the Consolidated Balance Sheet.
- (iii) KeySpan has guaranteed all payment and performance obligations of KeySpan Ravenswood, LLC, the lessee under the Master Lease. The term of the lease had been extended to June 20, 2009. This guarantee has been terminated following the termination of the Master Lease in June 2008, other than with respect to certain continued indemnity obligations that are considered highly remote and likely immaterial.
- (iv) KeySpan has guaranteed all payment and performance obligations of KeySpan Ravenswood, LLC, the lessee under the sale/leaseback transaction associated with the Ravenswood Expansion, including future decommissioning costs. The initial term of the lease is for 36 years. As noted previously, this lease qualifies as an operating lease and is not reflected on the Consolidated Balance Sheet. The cash consideration for KeySpan Ravenswood, LLC includes a prepayment from TransCanada to KeySpan of these payments on a present value basis. KeySpan's requirement to make these regular payments will continue after the sale of KeySpan Ravenswood, LLC. TransCanada will provide various guarantees to ensure that KeySpan does not have a continuing interest in the performance of the plant.
- (v) KeySpan has agreed to indemnify the issuers of various surety and performance bonds associated with certain construction projects being performed by certain current and former subsidiaries. In the event that the subsidiaries fail to perform their obligations under contracts, the injured party may demand that the surety make payments or provide services under the bond. KeySpan would then be obligated to reimburse the surety for any expenses or cash outlays it incurs. Although KeySpan is not guaranteeing any new bonds for any of the former subsidiaries, KeySpan's indemnity obligation supports the contractual obligation of these former subsidiaries. KeySpan has also received from a former subsidiary an indemnity bond issued by a third party insurance company, the purpose of which is to reimburse KeySpan in an amount up to \$80 million in the event it is required to perform under all other indemnity obligations previously incurred by KeySpan to support such company's bonded projects existing prior to divestiture. At March 31, 2008, the total cost to complete such remaining bonded projects is estimated to be approximately \$16.0 million.
- (vi) KeySpan has guaranteed commodity-related payments for certain subsidiaries. These guarantees are provided to third parties to facilitate physical and financial transactions

involved in the purchase of natural gas, oil and other petroleum products for electric production and marketing activities. The guarantees cover actual purchases by these subsidiaries that are still outstanding as of March 31, 2008.

- (vii) KeySpan has arranged for stand-by letters of credit to be issued to third parties that have extended credit to certain subsidiaries. Certain vendors require us to post letters of credit to guarantee subsidiary performance under our contracts and to ensure payment to our subsidiary subcontractors and vendors under those contracts. Certain of our vendors also require letters of credit to ensure reimbursement for amounts they are disbursing on behalf of our subsidiaries, such as to beneficiaries under our self-funded insurance programs. Such letters of credit are generally issued by a bank or similar financial institution. The letters of credit commit the issuer to pay specified amounts to the holder of the letter of credit if the holder demonstrates that we have failed to perform specified actions. If this were to occur, KeySpan would be required to reimburse the issuer of the letter of credit.

To date, KeySpan has not had a claim made against it for any of the above guarantees and we have no reason to believe that our subsidiaries or former subsidiaries will default on their current obligations. However, we cannot predict when or if any defaults may take place or the impact any such defaults may have on our consolidated results of operations, financial condition or cash flows.

The Company owns a 26.25% ownership interest in the Millennium Pipeline Company LLC (“Millennium”), the developer of the Millennium Pipeline project. The Millennium Pipeline project is anticipated to have the capacity to transport up to 525,000 DTH of natural gas a day from Corning, New York to Ramapo, New York, interconnecting with the pipeline systems of various other utilities in New York. Subject to the receipt of certain remaining permits and financing, Millennium expects that the first phase of the project will be in service by November 2008.

KeySpan has guaranteed \$210 million of an \$800 million Millennium Pipeline construction loan. The \$210 million represents KeySpan’s proportionate share of the \$800 million loan based on KeySpan’s 26.25% ownership interest in the Millennium Pipeline project. In addition, Consolidated Edison, KEDLI and Columbia Transmission have each entered into precedent agreements to purchase capacity on the pipeline. Upon and subject to the terms and conditions set forth in Precedent Agreements, KeySpan has agreed to guarantee the full and prompt payment of \$15.8 million (the “Guaranteed Amount”) of the contingent \$60 million financial obligation that Millennium may incur for liquidated damages under the Precedent Agreements to Consolidated Edison and KEDLI. The liquidated damages are intended to reimburse Consolidated Edison and KEDLI for costs incurred to secure additional capacity if Millennium is unable to provide the contracted capacity. The \$15.8 million guaranteed amount reflects KeySpan’s proportionate share of the \$60 million of financial security that is required to be provided to Consolidated Edison and KEDLI pursuant to the Precedent Agreements based on KeySpan’s proportionate ownership interest in the Millennium Pipeline project. These guarantees have been accounted for in accordance with FIN 45 “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtness of Others.”

At March 31, 2008, the fair value of these guarantees was \$2.7 million and is reflected as a component of equity investments, and other deferred credits and other liabilities on the Consolidated Balance Sheet.

**NOTE D – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

The following table details the components of accumulated other comprehensive income (loss) for the fiscal years ended March 31, 2008 and 2007:

(in millions)	Unrealized Gains (Losses) on investments	Postretirement Benefit Liabilities	Cash Flow Hedges	Total Accumulated Other Comprehensive Income (Loss)
<b>March 31, 2006</b>	\$ 6.8	\$ (6.4)	\$ (4.8)	\$ (4.3)
Other comprehensive income (loss), net of taxes:				
Unrealized gains (losses) on securities	6.0	-	-	6.0
Unrealized gains (losses) on hedges	-	-	(17.5)	(17.5)
Change in additional minimum pension liability	-	(6.3)	-	(6.3)
Adjustment for the adoption of SFAS No. 158	-	(398.1)	-	(398.1)
Reclassification adjustment for gain (loss) included in net income	(3.5)	-	22.0	18.5
<b>March 31, 2007</b>	\$ 9.3	\$ (410.8)	\$ (0.2)	\$ (401.7)
Other comprehensive income (loss), net of taxes:				
Unrealized gains (losses) on investments	(13.6)	-	-	(13.6)
Unrealized gains (losses) on hedging	-	-	14.2	14.2
Change in pension and other postretirement provisions	-	(100.5)	-	(100.5)
Reclassification adjustment for gain included in net income	3.0	-	14.8	17.8
<b>March 31, 2008</b>	\$ (1.3)	\$ (511.3)	\$ 28.8	\$ (483.8)

**NOTE E – DERIVATIVE CONTRACTS AND HEDGING ACTIVITIES**

In the normal course of business, the Company’s subsidiaries are party to derivative instruments, such as futures, options, swaps, and physical forwards that are principally used to manage commodity prices associated with their natural gas and electric operations. These financial exposures are monitored and managed as an integral part of the Company’s overall Financial Risk Management Policy. Additionally, the Company continually assesses the cost relationship between fixed and variable rate debt. Consistent with its objective to minimize its cost of capital, the Company periodically enters into hedging transactions that effectively convert the terms of underlying debt obligations from fixed to variable or variable to fixed. The Company will generally engage in activities at risk only to the extent that those activities fall within commodities and financial markets to which it has a physical market exposure in terms and volumes consistent with its core business.

As discussed in greater detail below, certain derivative instruments employed by the Company are accounted for as cash-flow hedges or fair value hedges in the case of treasury related derivative instruments and receive hedge accounting treatment under SFAS 133.

The Company also employs derivative instruments that do not qualify for hedge accounting treatment. Most of these derivative instruments utilized by the Company are subject to SFAS 71 "Accounting for the Effects of Certain Types of Regulation" since the Company's rate agreements allow for the pass-through of the commodity costs of electricity and natural gas and the costs related to hedging activities.

### ***Financial Derivatives – Receiving Hedge Accounting***

#### *Regulated Utilities*

Derivative financial instruments are used to reduce the cash flow variability associated with the purchase price for a portion of future natural gas purchases associated with our gas distribution utilities. Our strategy is to minimize fluctuations in gas sales prices to our regulated firm gas sales customers in our New York and New England service territories.

Niagara Mohawk utilizes NYMEX gas futures contracts to accomplish the aforementioned strategy. At March 31, 2008 the fair value of these derivative instruments was \$10 million. This balance is recorded in accumulated other comprehensive income and will be reclassified into earnings over the next twelve months. Narragansett also utilizes NYMEX gas futures contracts to reduce cash flow variability associated with natural gas purchases. At March 31, 2008 the fair value of its derivative instruments was \$21 million. The maximum length of time over which Narragansett has hedged such cash flow variability is through March 2010. The estimated amount of gains associated with such derivative instruments that are recorded in accumulated other comprehensive income and that are expected to be reclassified into earnings over the next twelve months is \$17.7 million. Ineffectiveness associated with these outstanding derivative financial instruments was immaterial for the year ended March 31, 2008.

Derivative financial instruments are used to reduce the cash flow variability associated with the purchase price for a portion of future electricity purchases associated with certain of our electric distribution subsidiaries. Our strategy is to minimize fluctuations in electric sales prices to our regulated firm electric sales customers in our upstate New York service territory.

Niagara Mohawk utilizes NYMEX electric futures contracts to hedge a portion of its electricity purchases. The maximum length of time over which Niagara Mohawk has hedged such cash flow variability is through December 2008. The fair value of these derivative instruments at March 31, 2008 was \$10.3 million. The estimated amount of gains associated with such derivative instruments that are reported in accumulated other comprehensive income and that are expected to be reclassified into earnings over the next twelve months is \$10.3 million. Ineffectiveness associated with these outstanding derivative financial instruments was immaterial for the year ended March 31, 2008.

On April 1, 2008, the Company electively discontinued its cash flow hedge accounting treatment for Niagara Mohawk and Narragansett NYMEX gas futures. On June 1, 2008, the Company electively discontinued its cash flow hedge accounting treatment for Niagara Mohawk NYMEX electric swap contracts. The accounting for these derivative instruments are subject to SFAS 71. Therefore, subsequent changes in the fair value of these derivatives will be recorded as regulatory assets and regulatory liabilities.

### *Other*

Our Energy Investments subsidiary, Seneca-Upshur, utilizes OTC natural gas swaps to hedge the cash flow variability associated with the forecasted sales of a portion of its natural gas production. At March 31, 2008, Seneca-Upshur has hedge positions in place for approximately 70% of its estimated 2008 through 2009 gas production, net of gathering costs. We use market quoted forward prices to value these swap positions. The maximum length of time over which Seneca-Upshur has hedged such cash flow variability is through December 2009. The fair value of these derivative instruments at March 31, 2008 was a liability of \$7.0 million. As required by SFAS 141, at the time of the KeySpan Acquisition all accumulated other comprehensive income balances were reclassified into equity. As a result, \$5.1 million of losses are currently included in accumulated other comprehensive income and expected to be reclassified to earnings in the next twelve months. Ineffectiveness associated with these outstanding derivative financial instruments was immaterial for the period August 25, 2007 through March 31, 2008.

As of March 31, 2008, the above derivative financial instruments are designated as cash flow hedges under SFAS 133 and are not considered held for trading purposes as defined by current accounting literature. Accordingly, we carry the fair value of these derivative instruments on the Consolidated Balance Sheet as either a current or deferred asset or liability, as appropriate, and record the effective portion of unrealized gains or losses in accumulated other comprehensive income. Gains and losses are reclassified from accumulated other comprehensive income to the Consolidated Statement of Income in the period the hedged transaction affects earnings. Gains and losses on settled transactions are reflected as a component of revenue. Any hedge ineffectiveness that results from changes during the period in the price differentials between the index price of the derivative contract and the price of the purchase or sale for the cash flow that is being hedged is recorded directly to earnings.

### ***Financial Derivatives – Not Receiving Hedge Accounting***

#### *Regulated Utilities*

We use derivative financial instruments to reduce the cash flow variability associated with the purchase price for a portion of future natural gas purchases associated with our New York and Massachusetts gas service territories. Our strategy is to minimize fluctuations in gas sales prices to our regulated firm gas sales customers. At March 31, 2008 the fair value of these derivative instruments was \$110.9 million.

Niagara Mohawk has eight indexed swap contracts, expiring in fiscal year 2009 (June 2008), which resulted from the Niagara Mohawk Rate Plan. These derivatives are not designated as hedging instruments and are covered by regulatory rulings that allow the gains and losses to be recorded as regulatory assets or regulatory liabilities. As of March 31, 2008 Niagara Mohawk had recorded liabilities at the present value of \$51 million for these swap contracts and had recorded a corresponding swap contracts regulatory asset. The asset and liability are amortized over the remaining term of the swaps as nominal energy quantities are settled and they are adjusted as periodic reassessments are made of energy price forecasts. Niagara Mohawk will make these estimated payments of \$51 million during fiscal year 2009. Niagara Mohawk uses NYMEX gas futures to hedge the gas commodity component of its indexed swap contracts. These instruments, as used, do not qualify for hedge accounting status under SFAS 133, but are recorded under SFAS 71. The fair value of these derivatives at March 31, 2008 was \$10.7 million.

The accounting for the above derivative instruments is subject to SFAS 71. Therefore, the fair value of these derivatives is recorded as current or deferred assets and liabilities, with offsetting positions recorded as regulatory assets and regulatory liabilities on the Consolidated Balance Sheet. Gains or losses on the settlement of these contracts are initially deferred and then refunded to or collected from our customers consistent with regulatory requirements.

*Other*

The Company is required by the NYPSC to divest of the Ravenswood Generating Station. The Company is in the process of selling KeySpan Ravenswood, LLC, which owns the Ravenswood Generating Station. In addition, the NYPSC required the Company to enter into an energy agreement whereby it would no longer have a financial interest in the NYISO energy market clearing prices. In January 2008, KeySpan Ravenswood, LLC entered into a one-year energy tolling agreement with a single counterparty pursuant to the requirements of the NYPSC just mentioned. This agreement contains certain embedded derivatives that were determined to be clearly and closely related to the host contract and appropriately not valued. The Company has no other derivative positions associated with the Ravenswood Generating Station.

Based upon KeySpan's experience in the New York City electric capacity market and management's assessment that a financial opportunity existed related to this market, KeySpan entered into an International SWAP Dealers Association Master Agreement for a fixed for float unforced capacity financial swap (the "Swap Agreement") with Morgan Stanley Capital Group Inc. ("Morgan Stanley") on January 18, 2006 in an effort to enhance shareholder value. The Swap Agreement involves a financial transaction and was not intended to be an economic hedge on physical generation assets or a contract for the physical delivery of capacity or energy. However, the same market dynamics that impacted the physical generation business impacted the value of the financial Swap Agreement.

The Swap Agreement has a three year term that began on May 1, 2006. The notional quantity is 1,800,000kW (the "Notional Quantity") of In-City Unforced Capacity and the fixed price is \$7.57/kW-month ("Fixed Price"), subject to adjustment upon the occurrence of certain events. Cash settlement occurs on a monthly basis based on the In-City Unforced Capacity price determined by the relevant NYISO Spot Demand Curve Auction Market ("Floating Price"). For each monthly settlement period, the price difference equals the Fixed Price minus the Floating Price. If such price difference is less than zero, Morgan Stanley will pay KeySpan an amount equal to the product of (a) the Notional Quantity and (b) the absolute value of such price difference. Conversely, if such price difference is greater than zero, KeySpan will pay Morgan Stanley an amount equal to the product of (a) the Notional Quantity and (b) the absolute value of such price difference.

At contract inception, the initial fair value of the Swap Agreement was fully reserved under the provision of EITF 02-3 "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," due to KeySpan's assessment at that time that market prices for the underlying capacity were unobservable. Accordingly, no fair value was recorded at the inception of the contract.

In June 2006, stakeholders, including the NYPSC and the Consolidated Edison Company of New York, Inc. ("Con Ed"), complained to the NYISO that the summer 2006 In-City capacity market

prices did not decline as some expected following the introduction of additional capacity into the market. After a stakeholder process, the NYISO proposed additional supplier mitigation measures to the FERC, but the NYISO's filing was rejected. FERC instead opened an investigation of the New York City capacity market. The purpose of FERC's investigation was to determine whether changes in the market are needed to attract and maintain necessary infrastructure without over compensating or under compensating suppliers. Subsequently, FERC ordered the NYISO to file comprehensive market reforms. On October 4, 2007, the NYISO proposed new mitigation measures to FERC involving mitigation of both suppliers and purchasers, with the intended effect of establishing both price caps and, during times of surplus, bid floors. Comments and alternative proposals were filed with FERC on November 19, 2007.

On March 7, 2008, the FERC approved the NYISO In-City capacity mitigation measures and revised the In-City capacity bid caps. The revised bid caps are expected to result in the SWAP Agreement floating price being set to equal the strike price, thereby eliminating all cash flow between the Company and Morgan Stanley for the remaining term of the Swap Agreement. As required by SFAS 141, the Company calculated the fair value of this derivative instrument to be a liability of \$17.9 million at August 24, 2007 and such amount was recorded as a current liability. The Company does not anticipate any further cash settlements after payment of the \$17.9 million, based on current and expected NYISO bid caps.

### ***Physical Derivatives – Not Receiving Hedge Accounting***

#### *Regulated Utilities*

As a result of a USGen bankruptcy settlement agreement (Bankruptcy Settlement), NEP resumed the performance and payment obligations under power supply contracts that had been transferred to USGen when the Company divested its generating business. The Company continues to record a derivative liability of approximately \$94 million for the above-market portion of the power supply contracts with an equal offset to a corresponding regulatory asset. The performance and payment obligations will not affect the results of operations, as the Company will recover the above-market cost of the power supply contracts from customers through the contract termination charge. In accordance with the Bankruptcy Settlement, the Company received proceeds of approximately \$196 million in June 2005 from USGen. That amount relates in part to the power supply contracts and the Company is crediting that amount to customers through a reduction in rates through December 31, 2009.

SFAS 133 establishes criteria that must be satisfied in order for option contracts, forward contracts with optionality features, or contracts that combine a forward contract and a purchase option contract to qualify for the normal purchases and sales exception. Certain contracts for the physical purchase of natural gas associated with our regulated gas utilities do not qualify for normal purchases under SFAS 133. Additionally, our regulated gas utilities have gas transportation service agreements with large generating facilities that contain embedded derivatives. At March 31, 2008, these derivatives had a net fair value of \$40.3 million and are subject to SFAS 71 accounting treatment described earlier.

#### *Other*

The utility tariffs associated with certain of our gas utilities do not contain weather normalization adjustments. As a result, fluctuations from normal weather may have a significant positive or negative effect on the results of these operations.

The Company has heating-degree day put options to mitigate the effect of fluctuations from normal weather on KEDNE's financial position and cash flows for the 2007/2008 winter heating season – November 2007 through March 2008. These put options would have paid the Company \$40,000 per heating degree day when the actual temperature was approximately 5% warmer than normal or below 4,141 heating degree days, based on the most recent 20-year average for normal weather. The maximum amount the Company would have received on these purchased put options was \$16 million. The net premium cost for these options was \$1.9 million and was amortized over the heating season. Since weather was colder than normal during the November 2007 through March 2008 heating season, these weather derivatives had no value.

We account for these derivatives pursuant to the requirements of EITF 99-2, "Accounting for Weather Derivatives." In this regard, such instruments are accounted for using the "intrinsic value method" as set forth in such guidance.

### ***Treasury financial instruments***

Financial derivative are used for hedging purposes in the management of exposure to interest rate risk enabling the Company to optimize the overall cost of accessing debt capital markets, and mitigating the market risk which would otherwise arise from the maturity of its treasury related assets and liabilities.

Treasury related derivative instruments may qualify as either fair value hedges or cash flow hedges. At present, the Company uses fair value hedges, consisting of interest rate and cross-currency swaps that are used to protect against changes in the fair value of fixed-rate, long-term financial instruments due to movements in market interest rates. For qualifying fair value hedges, all changes in the fair value of the derivative financial instrument and changes in the fair value of the item in relation to the risk being hedged are recognized in the income statement. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortized to the income statement as a yield adjustment over the remainder of the hedging period.

At March 31, 2008, \$13.9 million of \$541.5 million National Grid USA debt has been hedged. Net losses on the derivative financial instrument included in the income statement was \$0.9 million and has been recorded as finance costs.

### ***Credit and Collateral***

Derivative contracts are primarily used to manage exposure to market risk arising from changes in commodity prices and interest rates. In the event of non-performance by a counterparty to a derivative contract, the desired impact may not be achieved. The risk of counterparty non-performance is generally considered a credit risk and is actively managed by assessing each counterparty credit profile and negotiating appropriate levels of collateral and credit support. In instances where the counterparties' credit quality has declined, or credit exposure exceeds certain levels, we may limit our credit exposure by restricting new transactions with counterparties, requiring additional collateral or credit support and negotiating the early termination of certain agreements. At March 31, 2008, the Company has received \$19.2 million from its counterparties as collateral associated with outstanding derivative contracts. This amount has been recorded as

restricted cash, with an offsetting position in current liabilities on the Consolidated Balance Sheet. Additionally, the Company has \$4.3 million of collateral held by counterparties at March 31, 2008.

## **NOTE F - EMPLOYEE BENEFITS**

### *Summary*

The Company and its subsidiaries have defined benefit pension plans covering substantially all employees. The pension plans are non-contributory and tax qualified defined benefit plans which provide all employees with a minimum retirement benefit. Benefits are based on compensation and / or years of service.

The Company and its subsidiaries have defined benefit postretirement benefit plans other than pensions (PBOP) which provide health care and life insurance coverage to eligible retired employees. Eligibility is based on certain age and length of service requirement and, in most cases, retirees must contribute to the cost of their coverage.

Supplemental nonqualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives. A similar retirement program is provided to non-executive employees who have compensation or benefits in excess of the qualified plan limits.

The Company and its subsidiaries also offer employees a defined contribution plan. Plans are available to all eligible employees. Eligible employees contributing to the plans may receive certain employer contributions including matching contributions.

New York based pension and PBOP plans amortize prior service costs and gains and losses over a 10 year period calculated on a vintage year basis as required by the regulatory policy.

### *Funding Policy*

On a tax-deductible basis, the company will contribute amounts collected in rates to the pension plans until 100 percent to 110 percent of the Pension Protection Act of 2006 (the PPA) funding target is reached. The Company will contribute no less than the minimum amounts required by PPA, even if such amounts exceed the amounts collected in rates.

The Company will contribute amounts to the PBOP plans that are in compliance with the regulatory requirements of the various regulated jurisdictions within which the company operates.

*Plan Assets*

The target asset allocations for the benefit plans at March 31 are:

	Pension Benefits		Non-Union PBOP		Union PBOP	
	2008	2007	2008	2007	2008	2007
U.S. equities	<b>42%</b>	37%	<b>46%</b>	33%	<b>49%</b>	50%
Global equities (including U.S.)	<b>3%</b>	5%	<b>1%</b>	0%	<b>0%</b>	0%
Global tactical asset allocation	<b>7%</b>	13%	<b>0%</b>	0%	<b>0%</b>	0%
Non-U.S. equities	<b>13%</b>	10%	<b>16%</b>	17%	<b>21%</b>	23%
Fixed income	<b>31%</b>	31%	<b>32%</b>	50%	<b>28%</b>	27%
Private equity and other	<b>4%</b>	4%	<b>5%</b>	0%	<b>2%</b>	0%
	<b>100%</b>	100%	<b>100%</b>	100%	<b>100%</b>	100%

The percentage of the fair value of total plan assets at March 31 is:

	Pension Benefits		Non-Union PBOP		Union PBOP	
	2008	2007	2008	2007	2008	2007
U.S. equities	<b>40%</b>	38%	<b>44%</b>	35%	<b>45%</b>	50%
Global equities (including U.S.)	<b>3%</b>	6%	<b>0%</b>	0%	<b>0%</b>	0%
Global tactical asset allocation	<b>7%</b>	12%	<b>0%</b>	0%	<b>0%</b>	0%
Non-U.S. equities	<b>14%</b>	11%	<b>18%</b>	18%	<b>19%</b>	24%
Fixed income	<b>31%</b>	30%	<b>31%</b>	47%	<b>34%</b>	26%
Private equity and other	<b>5%</b>	3%	<b>7%</b>	0%	<b>2%</b>	0%
	<b>100%</b>	100%	<b>100%</b>	100%	<b>100%</b>	100%

The Company manages benefit plan investments to minimize the long-term cost of operating the plans, with a reasonable level of risk. Risk tolerance is determined as a result of a periodic asset/liability study which analyzes plan liabilities and plan funded status and results in the determination of the allocation of assets across equity and fixed income securities. Equity investments are broadly diversified across U.S. and non-U.S. stocks, as well as across growth, value, and small and large capitalization stocks. Likewise, the fixed income portfolio is broadly diversified across the various fixed income market segments. Small investments are also held in private equity with the objective of enhancing long-term returns while improving portfolio diversification. For the PBOP plans, since the earnings on a portion of the assets are taxable, those investments are managed to maximize after tax returns consistent with the broad asset class parameters established by the asset allocation study. Investment risk and return are reviewed by the investment committee on a quarterly basis.

The estimated rate of return for various passive asset classes is based on both analysis of historical rates of return and forward looking analysis of risk premiums and yields. Current market conditions, such as inflation and interest rates, are evaluated in connection with the setting of the long-term assumption. A small premium is added for active management and rebalancing of both equity and fixed income. The rates of return for each asset class are then weighted in accordance with the plans' target asset allocation, and the resulting long-term return on asset rate is then applied to the market-related value of assets.

*Assumptions Used for Benefits Accounting*

The following weighted average assumptions were used to determine the pension and PBOP benefit obligations and net periodic benefit costs for the fiscal years ending March 31.

	<b>Pension benefits</b>			
	<b>Benefit obligation</b>		<b>Net periodic benefit costs</b>	
	<b>2008</b>	2007	<b>2008</b>	2007
Discount rate	<b>6.50%</b>	6.00%	<b>6.00% - 6.50%</b>	6.00%
Rate of compensation increase	<b>3.50%-4.0%</b>	3.90% - 4.30%	<b>3.50% - 5.00%</b>	3.90% - 4.30%
Expected long-term rate of return on assets	<b>n/a</b>	n/a	<b>8.00%</b>	8.00%

	<b>PBOP</b>			
	<b>Benefit obligation</b>		<b>Net periodic benefit costs</b>	
	<b>2008</b>	2007	<b>2008</b>	2007
Discount rate	<b>6.50%</b>	6.00%	<b>6.00% - 6.50%</b>	6.00%
Expected long-term rate of return on assets	<b>n/a</b>	n/a	<b>7.00% - 8.25%</b>	7.80%
Health care cost trend rate				
Initial - pre 65	<b>9.00%</b>	9.50%	<b>9.00% - 9.50%</b>	10.00%
Initial - post 65	<b>10.00%</b>	10.50%	<b>10.00% - 10.50%</b>	11.00%
Ultimate	<b>5.00%</b>	5.00%	<b>5.00%</b>	5.00%
Year ultimate rate reached - pre 65	<b>2014</b>	2012	<b>2012</b>	2011
Year ultimate rate reached - post 65	<b>2015</b>	2013	<b>2013</b>	2012

The expected contributions to the Company's pension and PBOP plans during fiscal year 2009 are expected to be \$320.3 million and \$253 million, respectively.

**Pension Benefits**

The Company's net periodic benefit cost for the fiscal years ended March 31, 2008 and 2007 included the following components:

(In millions)	<b>2008</b>	2007
Service Cost	\$ <b>93.2</b>	\$ 55.3
Interest Cost	<b>276.1</b>	163.1
Expected return on plan assets	<b>(322.7)</b>	(174.5)
Amortization of prior service cost	<b>5.0</b>	4.9
Amortization of loss	<b>61.8</b>	58.3
Net periodic benefit costs before settlements and curtailments	<b>113.4</b>	107.1
Settlement and curtailment loss	<b>0.7</b>	25.6
Special termination benefits (VERO)	<b>50.3</b>	-
<b>Net periodic benefit cost</b>	<b>\$ 164.4</b>	\$ 132.7

The following table provides the changes in the pension plans' accumulated benefit obligation, funded status and the amounts recognized in the balance sheet at March 31:

(In millions)	2008	2007
<b>Accumulated benefit obligation</b>	<b>\$ (5,027.6)</b>	<b>\$ (2,603.5)</b>
<b>Reconciliation of benefit obligation:</b>		
Benefit obligation at beginning of period	(2,897.2)	(2,748.5)
Service cost	(93.2)	(55.4)
Interest cost	(276.1)	(163.1)
Actuarial gain (loss)	163.4	(87.0)
Benefits paid	364.8	156.7
Plan Amendments	(8.4)	-
Settlements	(41.8)	165.9
Acquisition	(2,741.5)	(165.9)
<b>Benefit obligation at end of period</b>	<b>(5,530.0)</b>	<b>(2,897.2)</b>
Fair value of plan assets at beginning of period	2,494.8	2,147.6
Actual return on plan assets	(110.9)	220.8
Company contributions	437.8	295.4
Benefits paid	(364.8)	(156.7)
Settlements	(0.7)	(165.9)
Acquisition	2,621.2	153.6
<b>Fair value of plan assets at end of period</b>	<b>5,077.4</b>	<b>2,494.8</b>
<b>Funded status</b>	<b>\$ (452.6)</b>	<b>\$ (402.4)</b>

On August 24, 2007, the Company acquired KeySpan. In connection with this acquisition, KeySpan's pension plans merged with the existing pension plan, resulting in an increase in the assets and benefit obligations of the plan in the amounts of \$2.6 billion and \$2.7 billion, respectively.

On August 24, 2006, the Company acquired the Rhode Island gas distribution assets of New England Gas Company from Southern Union Company. In connection with this acquisition, four small pension plans merged with the existing pension plan, resulting in an increase in the assets and benefit obligation of the plan in the amounts of \$154 million and \$166 million, respectively.

(In millions)	2008	2007
<b>Amount recognized on the balance sheet consist of:</b>		
Current pension liability	(19.1)	(9.0)
Non-current pension liability	(433.5)	(393.4)
<b>Net amount recognized</b>	<b>\$ (452.6)</b>	<b>\$ (402.4)</b>

(In millions)	2008	2007
<b>Amount recognized in regulatory assets and AOCI consist of:</b>		
Net actuarial loss	\$ 785.9	\$ 586.1
Prior service cost	47.5	43.9
<b>Net amount recognized</b>	<b>\$ 833.4 *</b>	<b>\$ 630.0 *</b>

\* The above amounts are before adjustments for regulatory deferrals and deferred taxes

The estimated net actuarial loss and prior service cost for the defined benefit pension plans that will be amortized from accumulated other comprehensive income (loss) and regulatory assets into net periodic benefit cost during fiscal year 2009 are \$58.9 million and \$5.6 million, respectively.

The following pension benefit payments are expected to be paid:

(In millions)	Pension benefits
2009	\$ 358.6
2010	\$ 363.7
2011	\$ 368.0
2012	\$ 382.5
2013	\$ 401.6
2014-2018	\$ 2,096.6

#### *Defined Contribution Plan*

The Company also has several defined contribution pension plans primarily (section 401(k) employee savings fund plans) that cover substantially all employees. Employer matching contributions of approximately \$27 million and \$19 million were expensed in fiscal year 2008 and 2007, respectively.

#### *Settlement Losses*

The Company's pension plans have losses that have yet to be recognized in the income statement as a result of changes in the value of the projected benefit obligation and the plan assets due to experience different from that assumed and from changes in actuarial assumptions. Under SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits," a company must recognize a portion of its loss immediately when payouts from a plan exceed a certain amount. During the fiscal year ended March 31, 2008, a pension settlement loss of \$159,000 was recorded related to a nonqualified plan. It was not recoverable. Niagara Mohawk recognized a settlement loss of approximately \$26 million

during the fiscal year ended March 31, 2007 due to plan payouts that exceeded the threshold as prescribed in SFAS No. 88. During fiscal year 2007, Niagara Mohawk and the PSC staff reached an agreement that permits Niagara Mohawk to recover approximately 50 percent of the incurred pension settlement loss from rate payers.

### Postretirement Benefits Other than Pensions

The Company's total net periodic benefit cost of PBOPs for the fiscal years ended March 31, 2008 and 2007 included the following components:

(In millions)	2008	2007
Service cost	\$ 42.6	\$ 28.2
Interest cost	174.7	121.5
Expected return on plan assets	(101.7)	(76.7)
Amortization of prior service cost	13.3	13.3
Amortization of net loss	44.3	43.9
Net periodic benefit cost before special termination benefits	173.2	130.2
Special termination benefits (VERO)	1.4	-
<b>Net periodic benefit cost</b>	<b>\$ 174.6</b>	<b>\$ 130.2</b>

The following table provides a reconciliation of the PBOP plans' funded status and the amounts recognized in the balance sheet at March 31:

(In millions)	2008	2007
<b>Change in benefit obligation:</b>		
Benefit obligation at beginning of period	\$ (2,216.0)	(2,124.8)
Service cost	(42.6)	(28.2)
Interest cost	(174.7)	(121.5)
Actuarial loss	19.0	(6.9)
Benefits paid	157.5	118.3
Medicare subsidy	(2.2)	(5.4)
Plan amendments	(0.2)	-
Curtailement	7.4	-
Special termination benefits (VERO)	(1.5)	-
Acquisitions	(1,286.9)	(47.6)
<b>Benefit obligation at end of period</b>	<b>(3,540.2)</b>	<b>(2,216.0)</b>
<b>Change in plan assets:</b>		
Fair value of plan assets at beginning of period	1,044.7	988.2
Actual return on plan assets	(32.8)	100.9
Company contributions	93.4	53.2
Benefits paid	(153.8)	(110.6)
Acquisitions	522.7	13.0
<b>Fair value of plan assets at end of period</b>	<b>1,474.2</b>	<b>1,044.7</b>
<b>Funded status</b>	<b>\$ (2,066.0)</b>	<b>\$ (1,171.3)</b>

On August 24, 2007, the Company acquired KeySpan. In connection with this acquisition, the Company's assets and benefit obligations of the PBOP plan increased by \$523 million and \$1.3 billion, respectively.

On August 24, 2006, the Company acquired the Rhode Island gas distribution assets of New England Gas Company from Southern Union Company. In connection with this acquisition, the Company's assets and benefit obligation of the PBOP plan increased by \$13 million and \$48 million, respectively.

(In millions)	2008	2007
<b>Amount recognized on the balance sheet consist of:</b>		
PBOP liability	\$ (2,066.0)	\$ (1,171.3)
<b>Net amount recognized</b>	<b>\$ (2,066.0)</b>	<b>\$ (1,171.3)</b>

(In millions)	2008	2007
<b>Amount recognized in regulatory assets and AOCI consist of:</b>		
Net actuarial loss	\$ 585.9	\$ 521.9
Prior service cost	93.3	106.4
<b>Net amount recognized</b>	<b>\$ 679.2 *</b>	<b>\$ 628.3 *</b>

\* The above amounts are before adjustments for regulatory deferrals and deferred taxes.

The estimated net actuarial loss and prior service cost for the PBOP plans that will be amortized from regulatory assets into net periodic benefit cost during fiscal year 2009 are estimated to be \$55.9 million and \$13.3 million, respectively.

As a result of the Medicare Act of 2003, the Company receives a federal subsidy for sponsoring a retiree healthcare plan that provides a benefit that is actuarially equivalent to Medicare Part D.

The following PBOP benefit payments expected to be paid and subsidies expected to be received from the U.S. Federal Government, which reflect expected future services as appropriate are:

(In millions)	Payments	Subsidies
2009	\$ 190.2	\$ 10.7
2010	\$ 201.5	\$ 11.8
2011	\$ 212.4	\$ 12.8
2012	\$ 221.2	\$ 13.8
2013	\$ 228.0	\$ 14.9
2014-2018	\$ 1,241.7	\$ 82.1

The assumptions used in health care cost trends have a significant effect on the amounts reported. A one percent change in the assumed rates would have the following effects:

(in millions of dollars)	<b>2008</b>	
<b>Increase 1%</b>		
Total of service cost plus interest cost	\$	31.7
Postretirement benefit obligation	\$	498.1
<b>Decrease 1%</b>		
Total of service cost plus interest cost	\$	(26.0)
Postretirement benefit obligation	\$	(423.8)

*Special Termination Benefits (Voluntary Early Retirement Offer)*

In connection with National Grid plc's acquisition of KeySpan, which was completed on August 24, 2007, National Grid plc and KeySpan offered certain non-union employees voluntary early retirement offer (VERO) packages in June 2007 in an effort to achieve necessary staff reduction through voluntary means; 560 employees enrolled in the VERO. Employees enrolled in the early retirement program will retire between October 1, 2007 and October 1, 2010. The cost of the VERO program is expected to be \$147 million. The Company recorded \$49 million of VERO costs for the fiscal year ended March 31, 2008, for program participants who retired as of April 1, 2008.

**NOTE G – INCOME TAXES**

The following is a summary of the components of federal and state income tax and reconciliation between the amount of federal income tax expense reported in the Consolidated Statements of Income and the computed amount at the statutory level.

Total income taxes from continuing operations in the consolidated statements of income are as follows:

(In millions of dollars)	<b>For the year ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Income taxes charged to operations	\$ 354.8	188.0
Income taxes credited to "Other income/deductions"	(10.0)	(4.0)
<b>Total income taxes</b>	<b>\$ 344.8</b>	<b>184.0</b>

(In millions of dollars)	<b>For the year ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Current income taxes	\$ 421.4	75.5
Deferred income taxes	(76.6)	108.5
<b>Total income taxes</b>	<b>\$ 344.8</b>	<b>184.0</b>

<i>(In millions of dollars)</i>	For the year ended March 31,	
	2008	2007
Federal income taxes	\$ 279.6	\$ 152.2
State income taxes	65.2	31.9
<b>Total income taxes</b>	<b>\$ 344.8</b>	<b>\$ 184.0</b>

The income tax amounts included in the Statement of Income differ from the amounts that result from applying the statutory federal income tax rate to income before income tax. The following is a reconciliation between reported income tax and tax computed at the statutory rate of 35%:

<i>(In millions of dollars)</i>	For the year ended March 31,			
	2008	Percent	2007	Percent
Computed tax at statutory rate	\$ 342.9	35.0	\$ 226.1	35.0
Increases (reductions) in tax resulting from:				
State income tax, net of federal income tax benefit	39.9	4.1	19.3	3.0
Book/tax depreciation not normalized	16.1	1.6	13.5	2.1
Intercompany Tax Sharing Adjustment	(17.5)	(1.8)	(28.0)	(4.0)
Medicare Subsidy	(13.5)	(1.4)	(12.7)	(1.9)
Cost of removal	(10.1)	(1.0)	(6.9)	(1.1)
Amortization of ITC, net	(6.2)	(0.6)	(6.2)	(1.0)
Reserve changes and other adjustments from prior years	(2.5)	(0.3)	(24.9)	(4.2)
All other differences	(4.3)	(0.4)	3.8	0.6
<b>Total income taxes</b>	<b>\$ 344.8</b>	<b>35.2</b>	<b>\$ 184.0</b>	<b>28.5</b>

With regulatory approval, the subsidiaries have adopted comprehensive interperiod tax allocation (normalization) for temporary book/tax differences.

At March 31, 2008 and 2007, the significant components of Company's deferred tax assets and liabilities calculated under the provisions of SFAS No.109 "Accounting for Income Taxes" were as follows:

<i>(In millions of dollars)</i>	At March 31,	
	2008	2007
Property related differences	\$ 2,790.3	\$ 1,428.0
Merger rate plan stranded costs	687.1	758.2
Property taxes	60.4	-
Investment Tax Credit	47.2	45.9
State income taxes	8.1	-
Employee benefits compensation	(840.8)	(405.1)
Reserves not currently deducted	(215.6)	(87.7)
Regulatory Assets	(51.6)	-
Environmental costs	(39.8)	(38.2)
Other items-net	(190.5)	172.9
Net deferred tax liability (asset)	2,254.8	1,874.0
Current deferred tax asset	(188.5)	(176.2)
Non-current deferred tax liability	\$ 2,443.3	\$ 2,050.2

The company has a deferred tax asset of approximately \$90 million for losses incurred by NGUSA in the state of Massachusetts that are carried forward to offset future earnings of the Company. Valuation allowances have been established for the full amount of these loss carry forwards as the Company believes that the losses will not be utilized in the foreseeable future.

As of March 31, 2008, the Company has approximately \$324 million of additional state net operating losses which will expire between 2011 and 2022.

In July 2006, the Financial Accounting Standards Board (“FASB”) issued Financial Interpretation (“FIN”) 48, “Accounting for Uncertainty in Income Taxes,” which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with Statement of Financial Accounting Standards (“SFAS”) 109, “Accounting for Income Taxes.” FIN 48 provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, assuming the taxing authority has full knowledge of all relevant information and that any dispute with a taxing authority is resolved by the court of last resort. Income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. Recognized tax benefits are measured as the largest amount of tax benefit that is more likely than not to be realized upon settlement with the taxing authority, assuming the taxing authority has full knowledge of all relevant information.

The Company adopted the provisions of FIN 48 on April 1, 2007. As a result of the implementation of FIN 48, the Company recognized approximately a \$92 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction in retained earnings of \$10.2 million, an increase to deferred tax assets of \$32.3 million, and an increase to goodwill of \$49.5 million to reflect the measurement under the rules of FIN 48 of uncertain tax positions related to previous business combinations

<b>Reconciliation of Unrecognized Tax Benefits (in millions)</b>	
Beginning balance, upon adoption as of April 1, 2007	\$ 93.3
Gross increases (decreases) related to current period	23.8
Settlements with tax authorities	14.5
Acquisitions*	343.1
Ending balance at March 31, 2008	\$ 474.7

\*On August 24, 2007, the Company acquired KeySpan. In connection with this acquisition, KeySpan’s tax liabilities, including liabilities for unrecognized tax benefits, were assumed by the Company.

As of March 31, 2008, the Company’s unrecognized tax benefits totaled \$474.7 million, of which approximately \$126.5 million would affect the effective tax rate, if recognized. Also included in the balance of unrecognized tax benefits at March 31, 2008 are tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the effect of deferred income tax accounting, other than for interest and penalties, the disallowance of the shorter deductibility period would not affect the effective income tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

Effective as of April 1, 2007, the Company recognizes interest accrued related to uncertain tax positions as interest income or interest expense and related penalties if applicable as operating expenses. Accrued interest and penalties are included within the related liability lines in the consolidated balance sheet as of March 31, 2008. In prior reporting periods, the Company recognized such accrued interest and penalties in income tax expense and taxes payable. The Company has accrued no penalties related to the uncertain tax benefits noted above. In total, the Company has accrued a liability for interest of \$54.2 million and \$106.5 million as of March 31, 2007 and March 31, 2008 respectively. During the fiscal year ended March 31, 2008, the Company accrued interest expense of \$20.4 million.

As of March 31, 2008, the Internal Revenue Service (IRS) completed its audit of the Company, excluding the KeySpan acquired companies, for the fiscal years ending March 31, 2003 and March 31, 2004. Certain adjustments proposed by the IRS are being appealed to the IRS Office of Appeals but the Company does not expect resolution within the next twelve months. The IRS is currently auditing the federal consolidated income tax returns of the Company, excluding the KeySpan acquired companies, for March 31, 2005 through March 31, 2007.

The IRS has also commenced the examination of KeySpan's consolidated income tax returns for the years ended December 31, 2000 through 2006. At this time, we cannot predict the result of these audits.

New York State has recently completed its audit, without change, of National Grid USA Service Company's separate company returns for the fiscal years ending March 31, 2003 through March 31, 2005. New York State is also currently auditing the combined report for fiscal years ending March 31, 2003 through March 31, 2005 for Niagara Mohawk. In addition, the Massachusetts Department of Revenue is conducting a field audit of the Company's Combined Returns for March 31, 2003 thru March 31, 2005. The Company is also in the process of appealing adjustments made by the Massachusetts Department of Revenue in a previous audit of its Massachusetts Combined Returns for January 1, 2000 thru March 31, 2002.

The Company believes that it is not reasonably possible that the tax liability for unrecognized tax benefits will significantly increase or decrease by March 31, 2009. As described above, the Company is subject to examination in the US and various state jurisdictions. At this time, the Company cannot predict the result of these audits or expect resolution within the next twelve months. The Company's, excluding the KeySpan acquired companies, fiscal years ended prior to March 31, 2003 are no longer subject to examination by federal or state authorities in the major jurisdictions in which the Company operates. The following table indicates the earliest KeySpan tax year subject to examination for each major jurisdiction:

Jurisdiction	Tax Year
Federal	2000
New York State	2000
Massachusetts	2000
New Hampshire	2003

On July 3, 2008 the state of Massachusetts signed into law H.4904 “An Act Improving Tax Fairness and Business Competitiveness” that imposes a combined reporting regime that will be effective for the Company’s tax year beginning April 1, 2009. The Company is currently evaluating the impact of this law change and at this time cannot determine the full impact that the new law may have on its financial statements.

On April 9, 2007, New York State enacted its 2007 - 2008 budget, which included amendments to the state income tax. Those amendments include a reduction in the corporate net income tax rate to 7.1% from 7.5%, and the adoption of a single sales factor for apportioning taxable income to New York State. Both amendments are effective January 1, 2007. The Company has evaluated the effects of the amendments and believes that the amendments will not have a material effect on its financial position, cash flows or results of operation.

#### **NOTE H – LONG-TERM DEBT**

*Notes Payable.* In 2006, KeySpan issued at KEDNY and KEDLI, respectively, \$400 million and \$100 million of Senior Unsecured Notes at 5.6% due November 29, 2016. Additionally, KEDLI has \$400 million of 7.875% Medium-Term Notes due February 1, 2010, outstanding at March 31, 2008 which is guaranteed by KeySpan.

KeySpan also has \$1.9 billion of medium and long term notes outstanding of which \$950 million of these notes were associated with its acquisition of Eastern Enterprise and EnergyNorth Inc. These notes were issued in two series as follows: \$700 million of 7.625% Notes due 2010 and \$250 million of 8.00% Notes due 2030. KeySpan also has \$160 million of 4.9% notes outstanding with a maturity date of May 2008 and \$307.2 million of 5.8% notes outstanding with a maturity date of April 2035 issued pursuant to the MEDS Equity Units conversion in 2005. The remainder of KeySpan’s debt of \$483.0 million had interest rates ranging from 4.65% to 9.75%. KEDLI repaid \$125 million of Medium-Term Notes at 6.90% at time of maturity, January 15, 2008.

Niagara Mohawk has a \$600 million Senior Note with an interest rate of 7.75% due October 1, 2008. This note is currently callable with make-whole provisions.

Granite State had \$15 million of long-term debt at March 31, 2008. This is made up of three \$5 million notes. The first \$5 million has an interest rate of 7.37% and has a maturity date of November 2023; the second \$5 million has an interest rate of 7.94% and has a maturity date of July 2025; and the third \$5 million has an interest rate of 7.3% and has a maturity date of June 2028. Granite State’s long-term debt covenants provide for certain restrictive covenants and acceleration clauses. These covenants stipulate that note holders may declare the debt to be due and payable if total debt becomes greater than 70% of total capitalization. At March 31, 2008, the total long-term debt was 17% of total capitalization.

New England Hydro Finance had \$41.2 million of 9.41% notes at March 31, 2008. These bonds have a monthly sinking fund requirement which totaled \$5.7 million during fiscal year end March 31, 2008. The monthly sinking fund requirement will be \$0.4 million until 2015. Debt covenants provide for certain restrictive covenants and acceleration clauses. These covenants stipulate that note holders may declare the debt to be due and payable if total debt becomes

greater than 70% of total capitalization. At March 31, 2008, the total debt was 59% of total capitalization.

***European Medium Term Note Program***

At March 31, 2008, NGUSA had a Euro Medium Term Note program (the “Program”) under which it is able to issue debt instruments (“Instruments”) up to a total of the equivalent of 4 billion Euro. At March 31, 2008, \$159.1 million of these notes were issued and outstanding, including the impact from the cross currency and interest rate swaps. Interest rates at March 31, 2008 ranged from 3.55% to 5.51%.

Instruments issued under the Program are admitted to trading on the London Stock Exchange. The Program commenced in December 2007 and is expected to be renewed annually for the foreseeable future. The funds raised under the Program may be used for general corporate purposes. Instruments may be issued in bearer form in any currency, with maturities ranging from one month to perpetuity. Instruments may not be offered, sold or delivered within the United States (US) or to a US person except in certain limited circumstances permitted by US regulations. Any fees associated with issuing Instruments under the Program are negotiated with the bank(s) managing the issuance at the time. Instruments issued under the Program rank pari passu with each other and with all other unsecured debt obligations of the Company, except to the extent that other debt obligations may be subordinated. Instruments carry certain positive and negative covenants, including a restriction on the Company’s ability to mortgage, pledge, charge or otherwise encumber its assets in order to secure, guarantee or indemnify other listed or quoted debt obligations, as well as cross-acceleration in the event of breach by the Company or its principal subsidiaries of other listed or quoted debt obligations. At March 31, 2008, the Company was in compliance with all covenants.

***Gas Facilities Revenue Bonds.*** KEDNY can issue tax-exempt bonds through the New York State Energy Research and Development Authority (“NYSERDA”). Whenever bonds are issued for new gas facilities projects, proceeds are deposited in trust and subsequently withdrawn to finance qualified expenditures. There are no sinking fund requirements on any of our Gas Facilities Revenue Bonds (“GFRBs”). At March 31, 2008, \$640.5 million of GFRBs were outstanding \$230 million of which are variable-rate auction bonds. The interest rate on the variable rate series due through July 1, 2026 is reset weekly and ranged from 3.00% to 6.27% for the period January 1, 2007 through March 31, 2008. The variable-rate auction bonds are currently in the auction rate mode and are backed by bond insurance. Credit rating agencies have recently downgraded the ratings of the bond insurers. The resulting interest rate on the bonds revert to the maximum rate which depends on the current commercial paper rates and the senior unsecured rating of KEDNY or the bond insurer, whichever is greater. To date, the effect on interest expense has not been material.

***Promissory Notes to LIPA.*** KeySpan and certain of its subsidiaries issued promissory notes to LIPA to support certain debt obligations assumed by LIPA in May 1998. At March 31, 2008, \$155.4 million of these promissory notes remained outstanding with maturity dates between 2013 and 2025. Under these promissory notes, KeySpan is required to obtain letters of credit to secure its payment obligations if its long-term debt is not rated at least in the “A” range by at least two nationally recognized statistical rating agencies. At March 31, 2008, KeySpan was in compliance with this requirement.

**Industrial Development Revenue Bonds.** At March 31, 2008, KeySpan had outstanding \$128.3 million of tax-exempt bonds with a 5.25% coupon maturing in June 2027 - \$53.3 million dollars of these Industrial Development Revenue Bonds were issued in its behalf through the Nassau County Industrial Development Authority for the construction of the Glenwood Energy Center, an electric-generation peaking plant, and the balance of \$75 million was issued in its behalf by the Suffolk County Industrial Development Authority for the Port Jefferson Energy Center an electric-generation peaking plant. KeySpan has guaranteed all payment obligations of these subsidiaries with regard to these bonds.

**First Mortgage Bonds.** Colonial Gas Company had outstanding \$85 million of first mortgage bonds at March 31, 2008. These bonds are secured by gas utility property. The first mortgage bond indentures include, among other provisions, limitations on: (i) the issuance of long-term debt; (ii) engaging in additional lease obligations; and (iii) the payment of dividends from retained earnings. At March 31, 2008, these bonds remain outstanding and have interest rates ranging from 6.3% to 8.8% and maturities that range from 2008-2028. Colonial repaid \$10 million of First Mortgage Bonds on their maturity date in March 2008.

Substantially all of the properties and franchise of Narragansett and Mass Electric are subject to the lien of mortgage indentures under which the First Mortgage Bonds have been issued. At March 31, 2008, Narragansett and Mass Electric had approximately \$65 million and \$55 million outstanding, respectively. During fiscal year end March 31, 2008, Narragansett redeemed \$7 million and \$3 million of 7.39% bonds due in 2027. During fiscal year end March 31, 2008 Mass Electric redeemed three series of bonds totaling \$40 million with various rates and various end maturity dates. At March 31, 2008, Narragansett's bond interest rates range from 6.65% to 10.25% and maturities range from June 2008 to December 2025. These bonds have \$1.6 million annual sinking fund requirements. Mass Electric's bond interest rates range from 5.72% to 6.66% and maturities range from June 2008 to November 2008.

**State Authority Financing Bonds.** Certain of KeySpan's electric generation subsidiaries can issue tax-exempt bonds through the NYSERDA. At March 31, 2008, \$41.1 million of Authority Financing Notes 1999 Series A Pollution Control Revenue Bonds due October 1, 2028 were outstanding. The interest rate on these notes is reset based on an auction procedure. The interest rate ranged from 3% to 17.75% during the period January 1, 2007 through March 31, 2008, at which time the rate was 6.85%.

KeySpan also has outstanding \$24.9 million variable rate 1997 Series A Electric Facilities Revenue Bonds due December 1, 2027. The interest rate on these bonds is reset weekly and ranged from 1.23% to 5.6% for the period January 1, 2007 through March 31, 2008, at which time the rate was 3.6%.

NEP had \$410.3 million of Pollution Control Revenue Bonds at March 31, 2008 issued through Business Finance Authority of the State of New Hampshire, Massachusetts Industrial Finance Authority, and Connecticut Development Authority. The Pollution Control Revenue Bonds are in tax-exempt commercial paper mode at March 31, 2008. Interest rates ranged from 1.75% to 2.45%. There are no payments or sinking fund requirements due in 2009 through 2013. At March 31, 2008, NEP had lines of credit and standby bond purchase facilities with banks totaling \$440 million, which is available to provide liquidity support for these bonds and for other corporate purposes. The agreement with banks that provide NEP's line of credit and

standby bond purchase facility expires on November 29, 2009. There were no borrowings under these facilities at March 31, 2008.

Substantially all of Niagara Mohawk's operating properties are subject to mortgage liens securing its mortgage debt. At March 31, 2008, \$650 million was outstanding. Several series of First Mortgage Bonds were issued to secure a like amount of tax-exempt revenue bonds issued through NYSERDA. Approximately \$575 million of such securities bear interest at short-term adjustable interest rates (with an option to convert to other rates, including a fixed interest rate) which averaged 4.36% for the fiscal year ended March 31, 2008. The bonds are currently in the auction rate mode and are backed by bond insurance. Credit rating agencies have recently downgraded the ratings of the bond insurers. The resulting interest rate on the bonds revert to the maximum rate which depends on the current commercial paper rates and the senior secured rating of Niagara Mohawk or the bond insurer, whichever is greater. The effect on interest expense has not been material at this time. The remaining \$75 million are fixed rate pollution control revenue bonds which are first callable on November 1, 2008 at 102%. Pursuant to agreements between NYSERDA and Niagara Mohawk, proceeds from such issues were used for the purpose of financing the construction of certain pollution control facilities at Niagara Mohawk's generation facilities (which Niagara Mohawk subsequently sold) or to refund outstanding tax-exempt bonds and notes.

Mass Electric had \$40 million outstanding at March 31, 2008 issued through Massachusetts Industrial Finance Agency. The bonds are in tax-exempt commercial paper mode with a variable interest rate of 2.40% at March 31, 2008. Of the \$40 million outstanding \$20 million was due on August 1, 2008 and the remaining \$20 million is due on August 1, 2014. At March 31, 2008, Mass Electric had a standby bond purchase facility with banks totaling \$45 million which is available to provide liquidity support for these bonds. The agreement with banks that provide the Mass Electric's standby bond purchase facility expires on November 29, 2009. There were no borrowings under this facility at March 31, 2008.

At March 31, 2008, Nantucket Electric had \$53 million of tax exempt bonds in commercial paper mode with variable maturity dates and variable interest rates ranging from 1.10% to 2.83%. The tax exempt bonds are guaranteed by Mass Electric and have maturities from March 2016 through August 2042. Mass Electric unconditionally guarantees the full and prompt payment of the principal premium, if any, and interest on these tax exempt bonds. The bonds were issued by the Massachusetts Development Finance Agency in connection with Nantucket Electric's financing of its first and second underground and submarine cable projects. Mass Electric would be required to make any principal, interest or premium payments if Nantucket Electric failed to pay. This guarantee is absolute and unconditional. At March 31, 2008, Nantucket Electric had a standby bond purchase facility with banks totaling \$70 million which is available to provide liquidity support for these tax-exempt bonds. The agreement with banks that provide the Nantucket Electric's standby bond purchase facility expires on November 29, 2009. There were no borrowings under this facility at March 31, 2008.

**Committed Facility Agreements.** At March 31, 2008, the Company had three committed bank loans outstanding. At March 31, 2008 \$382.5 million were outstanding, including the impact from the cross currency and interest rate swaps. These loans, which mature in 2011, are in various currencies and were used to provide funds for working capital needs. The interest rates

on these bank loans are reset periodically and range from 0.40% to 0.55% over issued currency LIBOR rate.

**Inter-Company Notes.** At March 31, 2008, Niagara Mohawk Holdings, Inc. has \$1.2 billion of inter-company note due to an affiliate of the Parent. This note has an interest rate of 5.52% and matures in November 2010.

**Debt Maturity.** The following table reflects the maturity schedule for our debt repayment requirements, including capitalized leases and related maturities, at March 31, 2008:

<i>(In Millions of Dollars)</i>	Long-Term Debt
Repayment for fiscal years:	
2009	\$ 992.6
2010	757.1
2011	1,302.0
2012	174.7
2013	517.2
Thereafter	3,803.5
	\$ 7,547.1

**Long-term Debt:** The following tables depict the fair values and carrying values of the Company's long-term debt at March 31, 2008 and 2007.

#### Fair Values of Long-Term Debt

<i>(In Millions of Dollars)</i>	At March 31,	
	2008	2007
Notes	\$ 3,720.9	\$ 892.7
Gas Facilities Revenue Bonds	636.0	-
Promissory Notes	155.9	-
Tax Exempt Bonds	120.6	-
First Mortgage Bonds	230.5	188.6
State Authority Financing Bonds	1,221.1	1,157.9
Committed Facilities	389.4	-
Inter-company Notes	1,200.0	1,200.0
	\$ 7,674.4	\$ 3,439.2

## Carrying Values of Long-Term Debt

<i>(In Millions of Dollars)</i>	At March 31,	
	2008	2007
Notes	\$ 3,615.4	\$ 861.9
Gas Facilities Revenue Bonds	640.5	-
Promissory Notes	155.4	-
Tax Exempt Bonds	128.3	-
First Mortgage Bonds	205.1	171.7
State Authority Financing Bonds	1,219.9	1,155.5
Committed Facilities	382.5	-
Inter-company Notes	1,200.0	1,200.0
	<u>\$ 7,547.1</u>	<u>\$ 3,389.1</u>

The Ravenswood Master lease is classified as a discontinued liability on the Consolidated Balance Sheet. The Fair Value and Carrying Value of the Ravenswood Master Lease at March 2008 were \$423.3 million and \$412.3 million, respectively. All other financial instruments included in the Consolidated Balance Sheet such as cash, commercial paper, accounts receivable, accounts payable and short-term debt instruments are stated at amounts that approximate fair value.

### ***Standby Bond Purchase Agreement***

At March 31, 2008 New England Power, Mass Electric and Nantucket Electric had a Standby Bond Purchase facility with banks totaling \$325 million, which is available to provide liquidity support for certain tax-exempt bonds. The agreement limits are \$210 million for New England Power, \$45 million for Mass Electric and \$70 million for Nantucket Electric. The fees for the facility are based on each entity's credit rating and are increased or decreased based on a downgrading or upgrading of the entity's rating. The facility fee for Nantucket Electric is based on the credit rating of Mass Electric. The current annual facility fee is 0.100% based on Mass Electric's and New England Power's credit rating of A3 by Moody's Investor Services and A- by Standard & Poor's.

The facility contains certain financial covenants that require New England Power and Mass Electric to maintain a debt to total capitalization ratio of no more than 65% at the last day of each fiscal quarter. For this calculation, indebtedness of Mass Electric does not include the guaranties by Mass Electric of certain tax-exempt bonds issued by Nantucket Electric and up to \$50 million of additional indebtedness of Nantucket Electric. At March 31, 2008, New England Power's indebtedness was 28% of its total capitalization and Mass Electric's indebtedness was 20% of its total capitalization. The agreement expires on November 29, 2009. There were no borrowings under the standby bond purchase agreement at March 31, 2008

### ***Credit Facility Agreements***

At March 31, 2008, the Company and certain of its subsidiaries had a Credit Facility agreement with a number of banks totaling \$355 million, which is available to provide letter of credit support and, in the case of New England Power, to provide liquidity support and other corporate

purposes. The agreement provides for an aggregate letter of credit limit of \$125 million, and a New England Power borrowing limit of \$230 million within which is included a New England Power letter of credit limit of \$30 million. The facility fee and utilization fee for the facility are based on the credit rating of New England Power and is increased or decreased based on a downgrading or upgrading of the rating. The current annual facility fee is 0.100% and the utilization fee is 0.125% based on New England Power's credit rating of A3 by Moody's Investor Services and A- by Standard & Poor's. The facility contains certain financial covenants that require the Company and certain of its subsidiaries named in the facility to maintain a debt to total capitalization ratio of no more than 65% at the last day of each fiscal quarter. For this calculation, indebtedness of Mass Electric does not include guaranties by Mass Electric of certain tax-exempt bonds issued by Nantucket Electric and of up to \$50 million of additional indebtedness of Nantucket Electric. At March 31, 2008, the Company and each of its subsidiaries named in the facility were in compliance with this covenant. The agreement expires on November 29, 2009. At March 31, 2008 \$42.4 million of letters of credit have been issued.

## **NOTE I – SHORT-TERM DEBT**

### *Commercial Paper and Revolving Credit Agreements.*

At March 31, 2008, KeySpan had two credit facilities totaling \$1.5 billion - \$920 million for five years through 2010, and \$580 million through 2009, which continue to support KeySpan's commercial paper program for ongoing working capital needs.

The fees for the facilities are based on KeySpan's current credit ratings and are increased or decreased based on a downgrading or upgrading of our ratings. The current annual facility fee is 0.08% based on our credit rating of Baa1 by Moody's Investor Services and A- by Standard & Poor's for each facility. Both credit facilities allow for KeySpan to borrow using several different types of loans; specifically, Eurodollar loans, ABR loans, or competitively bid loans. Eurodollar loans are based on the Eurodollar rate plus a margin that is tied to our applicable credit ratings. ABR loans are based on the higher of the Prime Rate, the base CD rate plus 1%, or the Federal Funds Effective Rate plus 0.5%. Competitive bid loans are based on bid results requested by KeySpan from the lenders. We do not anticipate borrowing against these facilities; however, if the credit rating on our commercial paper program were to be downgraded, it may be necessary to do so.

The facilities contain certain affirmative and negative operating covenants, including restrictions on KeySpan's ability to mortgage, pledge, encumber or otherwise subject its utility property to any lien, as well as certain financial covenants that require us to, among other things, maintain a consolidated indebtedness to consolidated capitalization ratio of no more than 65% at the last day of any fiscal quarter. Violation of these covenants could result in the termination of the facilities and the required repayment of amounts borrowed thereunder, as well as possible cross defaults under other debt agreements. At March 31, 2008, KeySpan was in compliance with all covenants.

Subject to certain conditions set forth in the credit facility, KeySpan has the right, at any time, to increase the commitments under the \$920 million facility up to an additional \$300 million. In

addition, KeySpan has the right to request that the termination date be extended for an additional period of 365 days prior to each anniversary of the closing date. This extension option, however, requires the approval of lenders holding more than 50% of the total commitments to such extension request. Under the agreements, KeySpan has the ability to replace non-consenting lenders with other pre-approved banks or financial institutions.

At March 31, 2008, \$286.8 million of commercial paper was outstanding and KeySpan had the ability to issue up to an additional \$1.2 billion under its commercial paper program.

At March 31, 2008, the Company was a named borrower under a credit facility in the name of the Parent totaling \$1.5 billion. This facility supports the Parent's and the Company's commercial paper programs for ongoing working capital needs.

The current annual facility fee is 0.09%. The credit facility allows both the Parent and the Company to borrow in Sterling or US Dollars, at the appropriate LIBOR rate plus a margin of 0.325%, or 0.375% if over \$750 million has been borrowed under the facility. We do not anticipate borrowing against this facility; however, if for any reason we were not able to issue sufficient commercial paper or source funds from other sources, it may be necessary to do so. The facility contains certain affirmative and negative operating covenants, including restrictions on the Company's utility subsidiaries' ability to mortgage, pledge, encumber or otherwise subject their utility property to any lien, as well as financial covenants that require the Company and the Parent to limit the total indebtedness in US and non-US subsidiaries to pre-defined limits. Violation of these covenants could result in the termination of the facilities and the required repayment of amounts borrowed there under, as well as possible cross defaults under other debt agreements. At March 31, 2008 the Company was in compliance with all covenants.

Subject to certain conditions set forth in the credit facility, the Parent and the Company have the right to "Term Out" the facility, whereby they may borrow in total up to the full facility amount of \$1.5 billion and this borrowing may remain outstanding for a further year beyond the expiration date of the facility. In addition, the Parent has the right to request that the termination date be extended for an additional period of 364 days prior to each anniversary of the closing date. This extension option requires the approval of lenders holding more than 50% of the total commitments to such extension request and only the lenders that consent will have their commitment extended. Under the agreements, the Parent has the ability to replace non-consenting lenders with other banks or financial institutions.

At March 31, 2008, \$828.2 million of commercial paper was outstanding under this facility. At March 31, 2008, the Company had the ability to issue up to an additional \$672 million under this facility.

#### Uncommitted Facility Agreements

At March 31, 2008, the Company had uncommitted loan facilities totaling \$720 million available from five banks of which, \$298 million was outstanding at March 31, 2008. These facilities provide liquidity for ongoing working capital needs by allowing the Company to borrow at very short notice. However, the lenders are not obliged to make a loan under the facilities at any time. The interest rates are set at the time of issuance and range from 20 basis points to 45 basis points

over LIBOR. Maturities are also set at the time of issuance and differ for from lender to lender. The drawn amounts outstanding at March 31, 2008 matured in April and May 2008.

Inter-company money pool

The Company and certain subsidiaries operate a money pool to more effectively utilize cash resources and to reduce outside short-term borrowings. Short-term borrowing needs are met first by available funds of the money pool participants. Borrowing companies pay interest at a rate designed to approximate the cost of third-party short-term borrowings. Companies that invest in the money pool share the interest earned on a basis proportionate to their average monthly investment in the money pool. Funds may be withdrawn from or repaid to the pool at any time without prior notice. The Company has the ability to borrow up to \$4 billion from the Parent (through intermediary entities) and certain other subsidiaries of the Parent, including for the purpose of funding the money pool, if necessary. At March 31, 2008, the Company had borrowed \$850 million under this arrangement. Additionally, the Company has a \$286.4 million promissory note outstanding with an affiliate of the Parent for the partial financing of certain notes issued by the Parent.

**NOTE J – CUMULATIVE PREFERRED STOCK**

The Company’s subsidiaries have certain issues of non-participating preferred stock which provide for redemption at the option of the Company, as shown in the table below. From time to time, the Company’s subsidiaries repurchase shares of its common stock or its preferred stock when it is approached on behalf of its shareholders. In fiscal year 2008, three of the subsidiaries redeemed total shares of 203,822 of its preferred stock for a combined consideration of \$17 million.

A summary of cumulative preferred stock at March 31, 2008 and 2007 is as follows (in thousands except for share data and call price):

	Company	Shares Outstanding		Amount (in millions)		Call Price
		March 31, 2008	March 31, 2007	March 31, 2008	March 31, 2007	
\$100 par value -						
3.40% Series	Niagara Mohawk	57,524	57,536	\$ 5.7	\$ 5.7	\$ 103.500
3.60% Series	Niagara Mohawk	137,139	137,139	13.7	13.7	104.850
3.90% Series	Niagara Mohawk	94,967	94,967	9.5	9.5	106.000
4.10% Series	Niagara Mohawk	-	52,830	-	5.3	102.000
4.44% Series	Mass Electric	22,585	22,585	2.3	2.3	104.068
4.76% Series	Mass Electric	-	24,680	-	2.4	103.730
4.85% Series	Niagara Mohawk	-	35,128	-	3.5	102.000
5.25% Series	Niagara Mohawk	-	34,115	-	3.4	102.000
6.00% Series	New England Power	11,117	11,117	1.1	1.1	(a)
\$50 par value -						
4.50% Series	Narragansett	49,089	49,089	2.5	2.5	55.000
4.64% Series	Narragansett	-	57,057	-	2.9	52.125
Total		372,421	576,243	\$ 34.8	\$ 52.3	

(a) Noncallable

## **NOTE K – COST OF REMOVAL AND ASSET RETIREMENT OBLIGATION**

SFAS No. 143, “Accounting for Asset Retirement Obligations” provides the accounting requirements for retirement obligations associated with tangible long-lived assets. Asset retirement obligations arising from legal obligations as defined under SFAS No. 143 amounted to \$48.7 million at March 31, 2008. Under the Company’s current and prior rate plans, it has collected through rates an implied cost of removal for its plant assets. This cost of removal collected from customers differs from the SFAS No. 143 definition of an asset retirement obligation in that these collections are for costs to remove an asset when it is no longer deemed usable (i.e. broken or obsolete) and not necessarily from a legal obligation. These collections have been recorded to a regulatory liability account to reflect future use. The Company estimates it has collected over time approximately \$1.3 billion and \$642 million for cost of removal through March 31, 2008 and 2007, respectively.

## **NOTE L –ACQUISITIONS**

### *Acquisition of KeySpan*

On August 24, 2007 National Grid plc purchased all the outstanding stock of KeySpan Corporation for \$42.00 per share in cash. The transaction has been accounted for using the purchase method of accounting for business combinations in accordance with SFAS 141 “Business Combination.” As a result of the acquisition, KeySpan ceased to be publicly traded. The purchase price of \$7.6 billion was allocated to KeySpan’s assets and liabilities based on their estimated fair values at the date of acquisition. The historical cost basis of KeySpan’s assets and liabilities associated with its gas distribution businesses, with minor exceptions, was determined to represent fair value due to the existence of regulatory-approved rate plans based upon the recovery of historical costs and a fair return thereon. Further, the historical cost basis of assets and liabilities associated with electric generating units on Long Island that are under long-term power supply agreements with LIPA, with minor exceptions, was determined to represent fair value due to the Power Supply Agreement with LIPA that provides for the recovery of historical costs and a fair return thereon. The excess of the purchase price over the fair value of the net assets acquired, or goodwill, was calculated to be \$3.9 billion including previously recorded goodwill at KeySpan. KeySpan has been consolidated into National Grid plc from August 24, 2007 onward.

The following table summarizes the fair value adjustments and calculation of goodwill:

<i>(In Millions of Dollars)</i>	
Purchase Price	\$ 7,574.3
KeySpan's Consolidated Equity at August 24, 2007	4,300.8
Goodwill Prior to Acquisition	1,665.9
KeySpan's Adjusted Consolidated Equity	2,634.9
Goodwill before Fair Value Adjustments	4,939.4
Fair Value Adjustments	
Assets Impacted:	
Accounts Receivable	(12.4)
Inventory	251.5
Other Property and Investments	(11.3)
Property Plant and Equipment	224.4
Regulatory Assets	221.6
Other Non-Current Assets	(75.3)
Liabilities Impacted:	
Accounts Payable	(46.7)
Accrued Taxes	(130.1)
Regulatory Liabilities	(189.6)
Accrued Employee Pension and Other Benefits and Reserves	(145.1)
Other Non-current Liabilities	(612.2)
Accumulated Deferred Income Tax	(20.0)
Long-term Debt	(58.2)
Net Adjustment	(603.4)
Intangible Asset Adjustment	230.8
Assets Held for Sale Fair Value Adjustments	1,373.7
Total Goodwill After Acquisition	\$ 3,938.3

A discussion of the more significant fair value adjustment follows.

*Other property and investments:* KeySpan owns a 600,000 barrel liquefied natural gas (“LNG”) storage and receiving facility in Providence, Rhode Island, through its wholly owned subsidiary KeySpan LNG. KeySpan LNG proposed to upgrade the liquefied natural gas facility to accept marine deliveries and to triple vaporization (or regasification) capacity to provide these services. The proposed upgrade was subject to numerous FERC proceedings, as well as proceedings with the Federal District Court in Rhode Island. At the time of the KeySpan acquisition, National Grid plc decided not to pursue the upgrade of the LNG facility. As a result, deferred project costs of \$11.3 million were written-off as a direct charge to equity.

*Property, Plant and Equipment:* As required by SFAS 141, upon acquisition KeySpan calculated the fair value of its property, plant and equipment for all its business segments. As noted previously, the historical cost basis of KeySpan's assets and liabilities associated with its gas distribution businesses, with minor exceptions, was determined to represent fair value due to the existence of regulatory-approved rate plans based upon the recovery of historical costs and a fair return thereon. Further, the historical cost basis of KeySpan's electric generating units on Long Island that are under long-term power supply agreements with LIPA, with minor exceptions, was determined to represent fair value. The historical cost basis of property, plant and equipment related to KeySpan's non-regulated business, primarily land, was increased by \$263.2 million to represent fair value at date of acquisition.

As discussed in Note A - "Significant Accounting Policies" under Item 9 - "Depreciation and Amortization", the Company maintains gas production and development activities through its two wholly-owned subsidiaries - KeySpan Exploration and Seneca-Upshur. As of March 31, 2008, the Company estimated that the capitalized costs associated with natural gas and oil reserves of these entities did not exceed the ceiling test limitation. However, the fair value exercise associated with SFAS 141 required a higher level of estimated operating costs and capital expenditures, compared to the same estimates required to be used in the ceiling test calculation resulting in a write down of \$30 million to the natural gas and oil reserves.

As part of its synergy savings strategy, the Company is relinquishing three floors in its Brooklyn headquarters at MetroTech. As a result, the Company reduced its property, plant and equipment by \$10.3 million associated with past leasehold improvement costs. Additionally, the Company will incur a \$10 million fee in consideration for the early termination of part of its lease of the MetroTech office. This fee has been recorded as a current liability on the Consolidated Balance Sheet.

*Regulatory Assets and Reserves:* Upon acquisition, KeySpan made certain adjustments to its pension and other postretirement reserve balances, as well as to its environmental reserve balances. KeySpan adjusted certain assumptions underlying the calculations for its pension and other postretirement reserves to align those assumptions with National Grid pension and postretirement reserve assumptions where appropriate. This alignment reduced KeySpan's pension and other postretirement reserves approximately \$180 million. Certain gas distribution subsidiaries are subject to certain deferral accounting requirements mandated by the various state regulators for pension costs and other postretirement benefit costs. As a result, approximately \$109 million of the decrease to the pension and other postretirement reserves was recorded as an "offset" to regulatory assets.

KeySpan also adjusted certain assumptions underlying the calculations for its environmental reserve to align those assumptions with National Grid plc's environmental reserve assumptions where appropriate. This alignment increased the Company's environmental reserve approximately \$343 million. Certain gas distribution subsidiaries are subject to certain deferral accounting requirements mandated by the various state regulators for environmental costs. As a result, approximately \$331 million of the increase to the environmental reserve was recorded as an "offset" to regulatory assets.

As noted in Note C, “Commitments and Contingencies”, the United States Court of Appeals for the District of Columbia Circuit (“Court”) denied the petitions of the NYISO and various New York Transmission Owners seeking refunds for charges in the January - March 2000 reserve market. As a result of this favorable decision, KeySpan reversed a previously established reserve for these proceedings of \$18.1 million. As required by SFAS 141, this amount was recorded as a direct benefit to equity.

*Accounts Payable and Other Liabilities:* As discussed in Note E, “Derivative Contracts and Hedging Activities”, on March 7, 2008, the FERC approved the NYISO In-City capacity mitigation measures and revised the In-City capacity bid caps. The revised bid caps are expected to result in the Swap Agreement (between the Company and Morgan Stanley) floating price being set to equal the strike price, thereby eliminating all cash flow between the two parties for the remaining term of the Swap Agreement. The fair value of this derivative instrument was calculated to be a liability of \$17.9 million at August 24, 2007; such amount was recorded as a current liability and a direct charge to equity.

Prior to the KeySpan Acquisition, KeySpan had a proposed project for the construction of a 250 MW combined cycle electric generation plant. In anticipation of this facility, KeySpan purchased a gas turbine generator several years ago. KeySpan and LIPA executed a “memo of understanding” for a power purchase agreement (“PPA”) in 2001; however the PPA was never executed by LIPA. As previously noted, the NYPSC ordered the Company to divest the Ravenswood Generating Station to mitigate concerns on vertical market power. National Grid plc is proceeding with such divestiture and as a result it is highly unlikely that a new investment in electric generation by National Grid plc would be possible. As a result, a \$7.5 million current liability was recorded for consideration of contract breakage costs associated with a maintenance contract for the gas turbine generator.

As discussed in Note C, “Commitments and Contingencies”, on May 31, 2007, KeySpan received a Civil Investigative Demand (“CID”) from the United States Department of Justice, Antitrust Division, requesting the production of documents and information relating to its investigation of competitive issues in the New York City electric energy capacity market. A \$5.3 million current liability was recorded representing the fair value for estimated legal fees associated with this proceeding.

*Regulatory Liabilities:* As part of the NYPSC approval of the KeySpan Acquisition, a Gas Rates Joint Proposal (“the Rates JP”) was agreed to by KeySpan, the NYPSC and the other parties. The Rates JP provides for five-year rate plans for KEDNY and KEDLI which go into effect on January 1, 2008. Included in the Rates JP are approximately \$189.6 million of certain ratepayer refunds that were agreed to by KEDNY and KEDLI. The significant terms of the Rates JP are discussed in Note B - “Rate and Regulatory.”

*Long-term Debt:* As part of the fair value exercise, KeySpan calculated the fair value of outstanding debt for all its non-regulated enterprises. This analysis required KeySpan to eliminate prior balances associated with debt discounts and premiums, as well as settled interest rate hedges that were being amortized. A \$58 million long-term liability was recorded as a result of this fair value analysis. The long-term debt associated with certain regulated gas distribution

businesses were not fair valued due to the existence of regulatory-approved rate plans that provide for the recovery of historical costs.

*Intangible Asset:* In addition to the above, certain intangible assets were created as a result of the acquisition. The MSA Agreement and the EMA Agreement with LIPA were valued at \$150.7 million. These intangible assets will be amortized over 20 years and 6 years respectively. Additionally, intangible assets of \$35.4 million were recorded for appliance service subsidiaries. These intangible assets relate to contractual relationships and plumbing licenses. The intangible asset associated with the plumbing license will be amortized over eight years, while the intangible asset associated with contractual relationships has an indefinite life.

*Fair Value of Assets Held for Sale:* As part of the purchase accounting exercise and in conjunction with the sale of the Ravenswood Generating Station and the engineering and telecommunications companies, an evaluation of the fair value of these investments was conducted. The evaluation resulted in an increase to the net book value of these companies of approximately \$1.3 billion, net of deferred taxes and estimated selling costs.

*Other Items:* As discussed in Note C, “Commitments and Contingencies” the Company will continue to be responsible for lease payments under the Sale/Leaseback arrangement associated with the Ravenswood Expansion throughout the remaining life of the arrangement. The remaining lease payments have been valued at \$363 million; such amount has been recorded in deferred credits and other liabilities.

KeySpan is entitled to emission credits associated with its electric generating facilities on Long Island. These emission credits had a fair value of \$296.2 million on August 24, 2007. As agreed to in the EMA Agreement with LIPA, LIPA is entitled to \$251.5 million of this amount which is included in inventory. The LIPA portion of the emission credits is reflected in deferred credits and other non-current liabilities and \$44.7 million as an intangible asset.

As allowed for under SFAS 141, the fair value measurement of assets, liabilities and intangible assets, and the resulting impact on goodwill and related allocations to the Company’s business units can be adjusted during the allocation period. However, such period is not to exceed one year. The fair value measurements discussed above are subject to change as a result of the following: (i) continued measurement of the fair value of the Ravenswood Generating Station assets that are held for sale; (ii) continued measurement of the fair value of the LIPA Service Agreements; (iii) finalization and measurement of the financial implications associated with the more significant aspects of the Gas Rates Joint Proposal;” (iv) measurement of the financial implications of the more significant aspects of the LIPA Service Agreement amendments; (v) continued measurement and identification of intangible assets; (vi) continue assessment of the deferred tax implications associated with the above adjustments and (vii) continued review of contingent liabilities. The preceding list is not intended to be all inclusive and the final determination of goodwill and intangible assets may be impacted by other fair value measurement adjustments.

Acquisition of Rhode Island Gas Assets

In fiscal year 2007, (August 24, 2006), the Company, acquired the Rhode Island gas distribution assets of New England Gas Company from Southern Union Company for approximately \$574 million which consisted of \$497 million in cash and the assumption of \$77 million of debt. The Company received a contribution from the Parent company in the amount of \$500 million to finance the acquisition, which is reflected in “Additional paid in capital”. As part of this transaction, the Company also acquired four small non-regulated businesses.

The acquisition was accounted for using the purchase method of accounting under SFAS 141. The assets acquired and liabilities assumed have been recorded in Narragansett’s balance sheet beginning August 24, 2006 at their fair values and the results of operations have been included in the Company’s statement of operations since August 24, 2006. Therefore, the Consolidated Balance Sheet and Statements of Operations for the periods subsequent to the acquisition are not comparable to the same periods in prior years.

The following table summarizes the fair values of NEG’s assets and liabilities assumed by Narragansett at the date of acquisition.

<i>(In millions of dollars)</i>	<b>At August 24, 2006</b>
Net utility plant	\$ 357.7
Goodwill	235.8
Other property and investments	4.5
Accounts receivable	72.5
Inventory	36.1
Other current assets	0.5
Regulatory assets	92.7
Other non-current assets	0.4
<b>Total assets acquired</b>	<b>800.2</b>
Long-term debt	76.1
Current portion of long-term debt	0.5
Accounts payable	29.4
Other current liabilities	39.5
Customer deposits	3.3
Accrued pension and other postretirement benefits	46.9
Other non-current liabilities	107.8
<b>Total liabilities assumed</b>	<b>303.5</b>
<b>Net assets acquired</b>	<b>\$496.7</b>

## NOTE M – DISCONTINUED OPERATIONS

The information below highlights the major classes of assets and liabilities of the discontinued operations, as well as major income and expense captions (in millions).

Income Statement Data		
<i>(In millions of dollars)</i>	<b>For the year ended March 31,</b>	
	<b>2008</b>	2007
Total operating revenues	\$ 374.4	\$ 74.0
Total operating expenses	315.2	62.1
Operating income	59.2	11.9
Total other income (expense)	14.0	(109.8)
Income (loss) before income taxes	73.2	(97.9)
Income tax provision (benefit)	30.2	10.6
<b>Net income</b>	<b>\$ 43.0</b>	<b>\$ (108.5)</b>

Balance Sheet Data		
<i>(In millions of dollars)</i>	<b>At March 31,</b>	
	<b>2008</b>	2007
<b>ASSETS</b>		
Total current assets	\$ 167.1	\$ 23.1
Deferred Charges	65.6	-
Property and Other Long Term Assets	2,792.7	286.1
<b>LIABILITIES AND STOCKHOLDER'S EQUITY</b>		
Total current liabilities	\$ 608.1	\$ 288.3
Deferred Credits and Other Liabilities	1,252.7	17.3
Total stockholder's equity	-	3.6

### National Grid Wireless

National Grid Wireless (Wireless), a subsidiary of the Company, owns, operates and manages towers and other communications structures. Wireless also manages a fiber optic telecommunications system in the Northeastern United States.

As part of the Company's strategy of focusing on energy markets, it committed during fiscal year 2007 to exit our wireless infrastructure operations. The wireless infrastructure operations were expanded during fiscal year 2007 with acquisitions at a cost of \$160 million. On August 15, 2007, the Company completed the sale of its wireless infrastructure operations for proceeds of approximately \$290 million. In fiscal year 2007, the Company reduced the carrying value of the assets held for sale by \$120 million, net of tax, to approximate fair value less selling costs. The final sale resulted in a pre-tax gain of approximately \$24 million primarily reflecting final working capital adjustments and other adjustments to the estimated selling price.

Following the guidance of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company has reported Wireless as a discontinued operation for all periods presented.

### KeySpan

On August 22, 2007 the NYPSC approved the merger application between KeySpan and National Grid plc. As a condition of the approval of the KeySpan Acquisition, the Company is required to divest the Ravenswood Generating Station. In addition, National Grid plc, has determined that the KeySpan telecommunications and engineering subsidiaries do not fit into the post-merger business model. As such, the Company will be exiting these businesses. The operating results and financial positions of these companies are reflected as discontinued operations on the Consolidated Statement of Income, Consolidated Balance Sheet and Consolidated Cash Flows. The sale of KeySpan's telecommunications business was completed on July 25, 2008. The assets and liabilities of this subsidiary were fair valued at August 24, 2008 and as a result the final sale has no material impact on the Consolidated Income Statement.

### Ravenswood Sale Transaction

On March 31, 2008, the Company announced that it had signed an agreement to sell KeySpan Ravenswood, LLC to TransCanada Corporation for total cash consideration of \$2.9 billion, payable upon completion of the sale ("Ravenswood Sale Transaction".) The total cash consideration includes working capital, fuel stock and a lease prepayment and is subject to customary closing conditions and adjustments.

The sale is subject to regulatory approvals of the FERC, the NYPSC and clearance under US anti-trust and foreign investment laws. Subject to these approvals, we expect to complete the sale by 2008 summer. On August 20, 2008 the NYPSC approved the sale of KeySpan Ravenswood, LLC.

In advance of this sale, the Company terminated the Ravenswood Master Lease (the lease under which KeySpan operates the Ravenswood Facility) on June 20, 2008, which was otherwise due to expire in 2009. Termination of the Master Lease results in the Company's ownership of the assets held under the lease. These assets and other assets are part of the assets being sold to TransCanada. The Ravenswood Sale Transaction also provides for the restructuring and transfer of our interest in the Ravenswood Expansion. However, we will remain responsible for all future lease payments under the sales/leaseback arrangement through May 2040. The total consideration received from the Ravenswood Sale Transaction includes a prepayment from TransCanada of the future payments under the sales/leaseback arrangement on a present value basis. (See Note C - "Commitments and Contingencies" for further details on the Master Lease and sales/leaseback arrangement.)

### **NOTE N - 2006 LIPA SETTLEMENT**

LIPA is a corporate municipal instrumentality and a political subdivision of the State of New York. On May 28, 1998, certain of the Long Island Lighting Company's ("LILCO's") business units were merged with KeySpan and LILCO's common stock and remaining assets were acquired by LIPA. Also effective on that date, KeySpan and LIPA entered into three major long-term service agreements that (i) provide to LIPA all operation, maintenance and construction services and significant administrative services relating to the Long Island electric transmission and distribution (T&D) system pursuant to a Management Services Agreement (the "1998 MSA"); (ii) supply LIPA with electric generating capacity, energy conversion and ancillary

services from our Long Island generating units pursuant to a Power Supply Agreement (the “1998 PSA”) and other long-term agreements through which we provide LIPA with approximately one half of its customers’ energy needs; and (iii) manage all aspects of the fuel supply for our Long Island generating facilities, as well as all aspects of the capacity and energy owned by or under contract to LIPA pursuant to an Energy Management Agreement (the “1998 EMA”). We also purchase energy, capacity and ancillary services in the open market on LIPA’s behalf under the 1998 EMA. The 1998 MSA, 1998 PSA and 1998 EMA all became effective on May 28, 1998 and are collectively referred to as the “1998 LIPA Agreements”.

On February 1, 2006, KeySpan and LIPA entered into (i) an amended and restated Management Services Agreement (the “2006 MSA”), pursuant to which we will continue to operate and maintain the electric T&D System owned by LIPA on Long Island; (ii) a new Option and Purchase and Sale Agreement (the “2006 Option Agreement”), to replace the Generation Purchase Rights Agreement (as amended, the “GPRA”), pursuant to which LIPA had the option, through December 15, 2005, to acquire substantially all of the electric generating facilities owned by the Company on Long Island; and (iii) a Settlement Agreement (the “2006 Settlement Agreement”) resolving outstanding issues between the parties regarding the 1998 LIPA Agreements. The 2006 MSA, the 2006 Option Agreement and the 2006 Settlement Agreement are collectively referred to herein as the “2006 LIPA Agreements.” The applicable rate components of each of the 2006 LIPA Agreements became effective retroactive to January 1, 2006, upon receipt of the required governmental approvals in 2007.

Following the announcement of the KeySpan Acquisition, LIPA, National Grid plc and KeySpan engaged in discussions concerning the impact of the transaction on LIPA’s operations. KeySpan, National Grid plc and LIPA reached an agreement pursuant to which LIPA agreed to waive its contractual right to terminate the 1998 LIPA Agreements and the 2006 LIPA Agreements upon consummation of the KeySpan Acquisition, in exchange for enhancements to certain of the 2006 LIPA Agreements and certain other considerations. The amended and enhanced agreements became effective upon the completion of the KeySpan Acquisition and the approval by the New York State Attorney General and the New York State Comptroller.

#### *2006 Settlement Agreement*

Pursuant to the terms of the 2006 Settlement Agreement, KeySpan and LIPA agreed to resolve issues that existed between the parties relating to the various 1998 LIPA Agreements. In addition to the resolution of these matters, KeySpan’s entitlement to utilize LILCO’s available tax credits and other tax attributes increased from approximately \$50 million to approximately \$200 million. These credits and attributes were used to satisfy KeySpan’s previously incurred indemnity obligation to LIPA for any federal income tax liability that resulted from the settlement with the IRS regarding the audit of LILCO’s tax returns for the years ended December 31, 1996 through March 31, 1999. On October 30, 2006, the IRS submitted the settlement provisions of the concluded IRS audit to the Joint Committee on Taxation for approval – such approval was granted in December 2007. Key provisions of the settlement included the resolution of the tax basis of assets transferred to KeySpan at the time of the KeySpan/LILCO merger, the tax deductibility of certain merger related costs and the tax deductibility of certain environmental expenditures. The settlement enabled KeySpan to utilize 100% of the available

tax credits. In recognition of these items, as well as for the modification and extension of the 1998 MSA and the amendments to the GPRA, KeySpan recorded a contractual asset in the amount of approximately \$160 million, of which approximately \$110 million was attributed to the right to utilize such additional credits and attributes and approximately \$50 million to be amortized over the eight year term of the 2006 MSA. This amount was subsequently adjusted to a \$ 130 million intangible asset upon the KeySpan Acquisition. In order to compensate LIPA for the foregoing, KeySpan paid LIPA \$69 million in cash and settled certain accounts receivable in the amount of approximately \$90 million due from LIPA.

#### *Generation Purchase Rights Agreement and 2006 Option Agreement.*

Under an amended GPRA, LIPA had the right to acquire certain of KeySpan's Long Island-based generating assets formerly owned by LILCO, at fair market value at the time of the exercise of such right. LIPA was initially required to make a determination by May 2005, but KeySpan and LIPA agreed to extend the date by which LIPA was to make this determination to December 15, 2005. As part of the 2006 settlement between KeySpan and LIPA, the parties entered into the 2006 Option Agreement whereby LIPA had the option during the period January 1, 2006 to December 31, 2006 to purchase only the steam generating units of the Far Rockaway and/or E.F. Barrett Generating Stations (and certain related assets) at a price equal to the net book value of each facility. In December 2006, KeySpan and LIPA entered into an amendment to the 2006 Option Agreement whereby the parties agreed to extend the expiration of the option period to the later of (i) December 31, 2007 or (ii) 180 days following the effective date of the 2006 Option Agreement. Pursuant to the National Grid plc, KeySpan and LIPA negotiations, the parties further amended the 2006 Option Agreement to extend the expiration of the option period to May 31, 2008, which was subsequently extended to December 31, 2008. The 2006 Option Agreement, as amended, replaces the GPRA. If LIPA were to exercise the option and purchase one or both of the generation facilities (i) LIPA and the Company will enter into an operation and maintenance agreement, pursuant to which the Company will continue to operate these facilities, through May 28, 2013, for a fixed management fee plus reimbursement for certain costs; and (ii) the 1998 PSA and 1998 EMA will be amended to reflect that the purchased generating facilities would no longer be covered by those agreements. It is anticipated that the fees received pursuant to the operation and maintenance agreement will offset the reduction in the operation and maintenance expense recovery component of the 1998 PSA and the reduction in fees under the 1998 EMA.

#### *Management Services Agreements*

In place of the previous compensation structure (whereby KeySpan was reimbursed for budgeted costs, and earned a management fee and certain performance and cost-based incentives), the Company's compensation for managing the T&D System under the 2006 MSA consists of two components: a minimum compensation component of \$224 million per year and a variable component based on electric sales. The \$224 million component remains unchanged for three years and then increase annually by 1.7%, plus inflation. The variable component, which comprises no more than 20% of the Company's compensation under the 2006 MSA, is based on electric sales on Long Island exceeding a base amount of 16,558 gigawatt hours, increasing by 1.7% in each year. Above that level, the Company receives approximately 1.34 cents per kilowatt hour for the first contract year, 1.29 cents per kilowatt hour in the second contract year (plus an annual inflation adjustment), 1.24 cents per kilowatt hour in the third contract year (plus

an annual inflation adjustment), with the per kilowatt hour rate thereafter adjusted annually by inflation. Subject to certain limitations, the Company retains all operational efficiencies realized during the term of the 2006 MSA.

LIPA continues to reimburse the Company for certain expenditures incurred in connection with the operation and maintenance of the transmission and distribution system, and other payments made on behalf of LIPA, including: real property and other transmission and distribution system taxes, return postage, capital construction expenditures and storm costs.

On July 19, 2007, LIPA signed an agreement addressing KeySpan's receipt of a Civil Investigative Demand (CID) from the United States Department of Justice, Antitrust Division (DOJ) regarding the DOJ's investigation into competitive issues in the New York City electric capacity market. The Letter Amendment to the 2006 MSA, dated as of June 29, 2007, amends the 2006 MSA to add an additional event of default, such that LIPA will have the contractual right to terminate the 2006 MSA if, in connection with the DOJ's investigation referenced in the CID, (a) there is a finding (through either a final, non-appealable judgment by a court of competent jurisdiction or final consent decree with the DOJ) that KeySpan or any of its affiliates violated Section 1 or 2 of the Sherman Act and (b) pursuant to which KeySpan or any of its affiliates is assessed or has agreed to be assessed a monetary or criminal penalty or sanction or is the subject of injunctive relief.

**NOTE O - APPLICATION OF SFAS 101 "REGULATED ENTERPRISES: ACCOUNTING FOR THE DISCONTINUATION OF APPLICATION OF FASB STATEMENT NO. 71" FOR THE LIPA SERVICE AGREEMENTS.**

As discussed in more detail in Note N "2006 LIPA Settlement," on May 28, 1998, KeySpan and LIPA entered into three major long-term service agreements. Negotiations between KeySpan and LIPA to amend certain aspects of these agreements were substantially concluded in 2006 and while KeySpan and LIPA performed in accordance with certain elements of these restated agreements beginning January 1, 2006, additional changes to these contract terms and the approvals needed to create binding agreements were not obtained until 2007. The changes in these service agreements impacted KeySpan's accounting for certain transactions conducted between KeySpan and LIPA.

Under both the original and amended and restated service agreements, KeySpan and now the Company are responsible for the management of employee benefit plans associated with employees providing service to LIPA and LIPA is responsible for the cost of funding and maintaining those plans. From May 28, 1998 through December 31, 2006, KeySpan followed SFAS 71, "Accounting for the Effects of Certain Types of Regulation", in accounting for the agreements with LIPA and capitalized as a receivable the difference between the accrued liability associated with these plans and the funding based upon the recoveries agreed to in the rate plans with LIPA.

Certain events occurred over the course of 2006 and 2007 that constituted a change in facts and circumstances that made the continued application of SFAS 71 no longer appropriate and therefore KeySpan implemented Statement of Financial Accounting Standard 101 "Regulated

Enterprises - Accounting for the Discontinuation of Application of FASB Statement No. 71” (“SFAS 101”) effective January 1, 2007. Specifically, management’s determination to apply SFAS 101, was based upon its analyses of the continued applicability of paragraph 5 of SFAS 71, as well as its assessment of the increasing competitive environment in relation to renewal of the service agreements with LIPA.

Paragraph 5 of SFAS 71, requires that regulated rates be set to recover the enterprise's specific costs of providing the regulated services or products. However, in two material respects these amended and restated agreements did not maintain the direct link between the cost of providing LIPA with the agreed to services and the revenues recovered in providing those services. First, these amended and restated agreements contained a revised revenue formula that introduced a departure from cost of service recovery that had been in place since 1998. Second, although, the Company’s rights to be reimbursed for employee benefit plan costs in the future have been completely preserved in the amended and restated service agreements, these rights of recovery are not fully reflected in the revised service agreements’ rates. Management has therefore concluded that the cause-and-effect relationship between costs and revenues no longer exists for its service agreements with LIPA.

Moreover, recent actions taken and comments made by New York State officials indicate renewal of the service agreements with LIPA will be based on competitive tendering using New York State procurement practices and standards as opposed to the practice to date where the utility franchise had effectively been awarded to KeySpan.

Based on facts and circumstances detailed above, management has concluded that the amended and restated service agreements no longer meet all of the relevant SFAS 71 criteria. As a result, KeySpan implemented SFAS 101 effective January 1, 2007, the beginning of the period in which the changes that give rise to the need for the discontinuance of SFAS 101 became probable. Implementation of SFAS 101 resulted in KeySpan derecognizing a \$442 million receivable with LIPA. KeySpan recorded a \$113.9 million (after tax) extraordinary charge for the pre-acquisition period January 1, 2007 through August 24, 2007. The remaining amount was initially recorded through accumulated other comprehensive income and then ultimately charged to goodwill, net of tax, as a result of purchase accounting adjustments.

#### **NOTE P – CHANGES IN EQUITY**

The increase in additional paid in capital on the Consolidated Balance Sheet from March 31, 2007 to March 31, 2008 primarily reflects the KeySpan Acquisition. Additionally, in June 2007, the Company repurchased its common stock for \$753 million which resulted in a decrease to other paid in capital of \$425 million and a return of capital to the Parent of \$328 million.

Commission Data Request 2-2

Request:

With regard to the estimated potential costs set forth on page 8, line 21 of Mr. Gerwatowski's pre-filed testimony, have these figures been made public in any other context? If so, please provide copies of any documentation.

Response:

See the response to Data Request 2-1.

Prepared by or under the supervision of: Ronald T. Gerwatowski

Commission Data Request 2-3

Request:

With regard to the estimated potential costs set forth on page 9, lines 18-19 of Mr. Gerwatowski's pre-filed testimony, have these figures been made public in any other context? If so, please provide copies of any documentation.

Response:

See the response to Data Request 2-1.

Prepared by or under the supervision of: Ronald T. Gerwatowski

Commission Data Request 2-4

Request:

Has National Grid made any public representations regarding estimated potential costs related to the “Civil Actions” referenced on page 3 of Mr. Gerwatowski’s pre-filed testimony? If so, please provide same.

Response:

See the response to Data Request 2-1.

Prepared by or under the supervision of: Ronald T. Gerwatowski

Commission Data Request 2-5

Request:

Have any documents been filed (not under seal) in the Civil Actions which make a claim for damages, specifying the amount of damages by any of the parties to the action? If so, please provide copies.

Response:

Yes, the value of the FCM Action (relating to UCAP and ASM Costs) is discussed in the following documents, which are attached:

- Constellation's Answer and Counterclaim at Paragraph 11 of the Counterclaim;
- The Division's Motion to Intervene at Page 10;
- The Division's Objection to Constellation's Motion to Stay at Page 8;
- The Division's Brief in the First Circuit Appeal at Page 25, footnote 5;
- February 7, 2007 Hearing Transcript before Judge Smith at Page 47.

The value of the FAF Costs is not specified in the unsealed documents in the FAF Action.

Prepared by or under the supervision of: Ronald T. Gerwatowski

**UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF RHODE ISLAND**

---

THE NARRAGANSETT ELECTRIC COMPANY,	)	
	)	
Plaintiff,	)	
	)	
STATE OF RHODE ISLAND AND PROVIDENCE	)	
PLANTATIONS and the RHODE ISLAND DIVISION	)	
OF PUBLIC UTILITIES AND CARRIERS,	)	
	)	
Intervenor-Plaintiff,	)	
v.	)	C.A. NO. 06-404S
	)	
CONSTELLATION ENERGY COMMODITIES	)	
GROUP, INC.,	)	
	)	
Defendant.	)	

---

**ANSWER, AFFIRMATIVE DEFENSES, AND COUNTERCLAIMS OF  
CONSTELLATION ENERGY COMMODITIES GROUP, INC.**

Constellation Energy Commodities Group, Inc. (“Constellation”) as its Answer to the Complaint of The Narragansett Electric Company (“NEC”) alleges and pleads as follows:

**PARTIES**

1. Constellation denies knowledge or information sufficient to form any belief about the accuracy of this allegation and, therefore, denies it.

2. Admitted.

**JURISDICTION AND VENUE**

3. To the extent the relief Plaintiff seeks entails abrogating or modifying any right Constellation enjoys under its wholesale power supply agreements with Plaintiff, Constellation denies this Court has subject matter jurisdiction; as to the allegations otherwise regarding

diversity jurisdiction and federal question jurisdiction, Constellation admits that there is diversity of citizenship, more than \$75,000 (exclusive of interests and costs) in dispute, and issues of federal regulatory orders in dispute.

4. Constellation states that paragraph 4 of the Complaint consists of legal arguments to which no response is required; to the extent that any answer is required, Constellation admits that venue is proper under 28 U.S.C. §1391(b), but contends that this Court should transfer venue under 28 U.S.C. §1404(a).

**FACTS**

5. Admitted.

6. Admitted.

7. Admitted.

8. Admitted.

9. Denied.

10. Constellation denies knowledge or information sufficient to form any belief about the accuracy of this allegation and, therefore, denies it.

11. Denied.

12. Constellation denies knowledge or information sufficient to form any belief about the accuracy of this allegation and, therefore, denies it.

13. Constellation denies knowledge or information sufficient to form any belief about the accuracy of this allegation and, therefore, denies it.

14. Constellation denies knowledge or information sufficient to form any belief about the accuracy of this allegation and, therefore, denies it.

15. Constellation denies knowledge or information sufficient to form any belief about the accuracy of this allegation and, therefore, denies it.

16. Constellation denies knowledge or information sufficient to form any belief about the accuracy of this allegation and, therefore, denies it, except that Constellation admits that the PPAs terminate before June 1, 2010.

17. Constellation denies the allegations of Paragraph 17 of the Complaint to the extent they are directed at it; as to all other allegations, Constellation's knowledge or information sufficient to form any belief about the accuracy of those allegations and, therefore, denies them.

18. Constellation denies knowledge or information sufficient to form any belief about the accuracy of those allegations and, therefore, denies them.

19. Denied.

20. Denied.

21. Constellation denies the allegations in Paragraph 21 of the Complaint to the extent that they are directed at it; as to all other allegations, Constellation denies knowledge or information sufficient to form any belief about the accuracy of those allegations and, therefore, denies them.

22. Denied, except that as for the allegations in Paragraph 22 quoting from Section VIII(A) of the Settlement Agreement, that document speaks for itself.

23. Constellation denies the allegations in Paragraph 23 of the Complaint to the extent that they are directed at it; as to all other allegations, Constellation denies knowledge or information sufficient to form any belief about the accuracy of those allegations and, therefore, denies them.

24. Admitted.

25. Constellation denies the allegations in Paragraph 25 of the Complaint to the extent that they are directed at it. As for the allegations in Paragraph 25 quoting from documents filed with FERC, these documents speak for themselves. As to all other allegations, Constellation denies knowledge or information sufficient to form any belief about the accuracy of those allegations and, therefore, denies them.

26. Admitted.

27. Admitted.

28. Admitted.

29. Constellation states that Paragraph 29 of the Complaint consist of a legal arguments to which no response is required; to the extent any answer is required, Constellation denies that the Settlement Agreement bars or precludes Constellation from exercising any right it enjoys under the PPAs.

**NEC'S DEMAND**

30. Constellation states that Paragraph 30 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein, except that Constellation admits it sent a letter dated August 1, 2006 to NEC, the terms of which speak for themselves.

31. Constellation states that Paragraph 31 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

32. Admitted.

33. Constellation states that Paragraph 33 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

**COUNT I**  
**Declaratory Judgment**

34. Constellation repeats and incorporates its responses to the allegations of Paragraphs 1 through 33 as if repeated herein.

35. Constellation states that Paragraph 35 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies that the Settlement Agreement bars or precludes Constellation from exercising any right it enjoys under the PPAs.

36. Constellation states that Paragraph 36 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

37. Constellation states that Paragraph 37 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation admits the allegations therein.

38. Constellation states that Paragraph 38 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

**COUNT II**  
**Waiver**

39. Constellation repeats and incorporates its response to the allegations of Paragraphs 1 through 38 as if repeated herein.

40. Constellation states that Paragraph 40 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

41. Constellation states that Paragraph 41 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

42. Constellation states that Paragraph 42 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

**COUNT III**  
**Declaratory Judgment**  
**(Transition Period UCAP Costs/PPAs)**

43. Constellation repeats and incorporates its response to the allegations of Paragraphs 1 through 42 as if repeated herein.

44. Constellation states that Paragraph 44 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

45. Constellation states that Paragraph 45 of the Complaint consists of legal arguments to which no response is required; to the extent that any response is required, Constellation admits the allegations therein.

46. Constellation states that Paragraph 46 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

**COUNT IV**  
**Declaratory Judgment**  
**(ASM/PPAs)**

47. Constellation repeats and incorporates its response to the allegations of Paragraphs 1 through 46 as if repeated herein.

48. Constellation states that Paragraph 48 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

49. Constellation states that Paragraph 49 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation admits the allegations therein.

50. Constellation states that Paragraph 50 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

**COUNT V**  
**Breach of Contract**  
**(The PPAs)**

51. Constellation repeats and incorporates its response to the allegations of Paragraphs 1 through 50 as if repeated herein.

52. Constellation states that Paragraph 52 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

53. Constellation states that Paragraph 53 of the Complaint consists of legal arguments to which no response is required; to the extent any response is required, Constellation denies the allegations therein.

### **AFFIRMATIVE DEFENSES**

#### **First Affirmative Defense**

54. This Court lacks subject matter jurisdiction over this dispute.

#### **Second Affirmative Defense**

55. NEC fails to plead a claim on which relief can be granted. NEC has no cognizable claim for relief, or for the recovery from Constellation of any costs, attorneys' fees or other expenses it may incur or have already incurred in conjunction with this proceeding.

#### **Third Affirmative Defense**

56. NEC is barred by the doctrine of estoppel from interposing or seeking to interpose any claim, allegation or other issue that would interfere with Constellation's lawful rights (including economic interests) under four Power Purchase Agreements (the "PPAs").

#### **Fifth Affirmative Defense**

57. NEC is barred by the doctrine of laches from interposing or seeking to interpose any claim, allegation or other issue that would interfere with Constellation's lawful rights (including economic interests) under the PPAs.

#### **Sixth Affirmative Defense**

58. NEC is barred by the doctrine of unclean hands from interposing or seeking to interpose any claim, allegation or other issue that would interfere with Constellation's lawful rights (including economic interests) under the PPAs.

**Seventh Affirmative Defense**

59. NEC is barred by the doctrine of release from interposing or seeking to interpose any claim, allegation or other issue that would interfere with Constellation's lawful rights (including economic interests) under the PPAs.

**Eighth Affirmative Defense**

60. NEC is barred by the doctrine of waiver from interposing or seeking to interpose any claim, allegation or other issue that would interfere with Constellation's lawful rights (including economic interests) under the PPAs.

**Ninth Affirmative Defense**

61. NEC's complaint is barred by the doctrine of accord and satisfaction.

**Tenth Affirmative Defense**

62. NEC's complaint is barred by the doctrine of failure of consideration.

**Eleventh Affirmative Defense**

63. NEC's complaint is barred by illegality in that no valid and lawful order of a duly empowered authority (namely, the Federal Energy Regulatory Commission) has abrogated or modified Constellation's rights under the PPAs, and this Court has no authority to grant any relief altering or hypothesizing alteration of any right enjoyed by Constellation under those four PPAs.

**Twelfth Affirmative Defense**

64. NEC's complaint is barred by the doctrine of frustration of purpose.

**Thirteenth Affirmative Defense**

65. NEC's complaint is barred by the doctrine of impossibility of performance.

**Fourteenth Affirmative Defense**

66. NEC has no cognizable claim to a jury trial as its claims sound in equity and not in law.

**Fifteenth Affirmative Defense**

67. The Court should transfer this matter to a different venue under 28 U.S.C. §1404. Venue is not in the interests of justice in this Court because Constellation cannot receive a fair and impartial trial before any jury comprised of NEC ratepayers in light of the State's professed abdication of any prudence review of costs under the PPAs that NEC seeks to pass on to ratepayers.

**Sixteenth Affirmative Defense**

68. The claims raised by NEC's complaint are properly the subject of binding arbitration and/or a stay under the Federal Arbitration Act.

**COUNTERCLAIM**

1. At issue in this Counterclaim are four Power Purchase Agreements ("PPAs") that the NEC and Constellation entered into between 1998 and 2002 , under which Constellation agreed to supply wholesale power to NEC for NEC's retail customers.

2. In each of the four PPAs, NEC and Constellation expressly conditioned their duties on the regulatory landscape remaining unchanged from the date of contract execution. Rather than allocate the risk of intervening regulatory change to one party or the other, each PPA has a provision that binds NEC and Constellation to negotiate an equitable adjustment of the contract in the aftermath of any market rule or regulatory change that alters the benefits and burdens (including economically) contemplated by the parties at the time of contracting.

3. In March 2006, just such a regulatory change took place. At the time, proceedings at the Federal Energy Regulatory Commission (“FERC”) resulted in a “Settlement Agreement” that not only significantly altered the regulatory framework for buying and selling what is know in the energy business as “capacity,” but also forever changed the rights and obligations of the NEC and Constellation under their four PPAs.

4. This significant regulatory change had a severe economic impact on Constellation, forcing it to buy “capacity” at a fixed price set by the Settlement Agreement, rather than on the open market, as was contemplated by the parties. From the time that the Settlement Agreement went into effect until the end of the four PPAs at issue in 2010, this change could adversely effect Constellation in amounts upwards of \$150 million.

5. On August 1, 2006, in response to this regulatory change, Constellation wrote to NEC and invoked its right to negotiate an equitable adjustment under the four PPAs. Rather than fulfilling its promise to negotiate in good faith and arbitrate this matter, as required by the PPAs, NEC filed this lawsuit.

6. Constellation now responds with these Counterclaims. Although this dispute is subject to arbitration under the agreement of the parties, NEC has sought to litigate. Despite the fact that the four PPAs at issue show that Constellation is entitled to an equitable adjustment to account for a shift in the regulatory framework, NEC has claimed that no such adjustment is available or required. And, although the Settlement Agreement entered into before FERC had no effect on Constellation’s right to an equitable adjustment under the four PPAs, NEC claims otherwise.

7. For these reasons, and the ones set forth below, Constellation seeks:

- a. an order from this Court staying all proceedings in this case and compelling the parties to arbitrate this dispute under the Federal Arbitration Act, 9 U.S.C. §§ 3-4;
- b. a declaration under 28 U.S.C. § 2201, that Constellation is entitled to an equitable adjustment under the four PPAs, and that NEC has breached these agreements by refusing to agree to such an adjustment;
- c. a declaration under 28 U.S.C. § 2201 that Constellation is entitled to recover the costs it incurred as a result of the implementation of the ancillary services market (“ASM”) phases I and II;
- d. a finding that NEC’s knowing and willful breach of the four PPAs has resulted in damages to Constellation of \$150 million and award of damages in that amount; and
- e. alternatively, in the event that the four PPAs do not cover the subject matter of this dispute, a finding that NEC has been unjustly enriched in the amount of \$150 million and that it is, therefore, liable to Constellation under the doctrines of quasi-contract, unjust enrichment, and/or quantum meruit in that amount.

#### **PARTIES**

8. Constellation is a corporation duly organized and existing under the laws of the State of Delaware with its principal place of business located at 11 Market Place, Suite 500, Baltimore, Maryland, and the successor by name change to Constellation Power Source, Inc.
9. On information and belief, NEC is a corporation organized and existing under the laws of Rhode Island with its principal place of business at 280 Melrose Street, Providence, Rhode Island.

10. On information and belief, NEC is the successor by merger to Blackstone Valley Electric Company and Newport Electric Corporation—the original Rhode Island parties to the two PPAs executed in 1998.

### **JURISDICTION AND VENUE**

11. This Court has diversity jurisdiction under 28 U.S.C. § 1332 because NEC and Constellation are citizens of different states and the matter in controversy exceeds the sum or value of \$75,000, exclusive of interest and costs.

12. This Court also has federal question jurisdiction under 28 U.S.C. § 1331 because the action arises under the laws of the United States.

13. This Court also possesses supplemental jurisdiction pursuant to 28 U.S.C. § 1367.

14. Venue for Constellation’s Counterclaims is proper in this District pursuant to 28 U.S.C. § 1391.

### **FACTUAL BACKGROUND**

#### **A. NEC and Constellation**

15. NEC is a retail electric distribution company that delivers electricity to retail end-user customers in Rhode Island. Constellation sells at wholesale in interstate commerce power (“energy” and “capacity”) to NEC that partially meets NEC’s overall requirements.

16. For many years, NEC and Constellation have enjoyed a customer-supplier relationship. Between 1998 and 2002, the parties entered into four PPAs under which Constellation agreed to supply wholesale power to NEC for NEC’s retail customers. These agreements are as follows:

a. Wholesale Standard Offer Service Agreement between Blackstone Valley Electric Company, Eastern Edison Company, Newport Electric Corporation and Constellation Power Source, Inc. (dated December 21, 1998, and amended on January 27, 2003 and June 3, 2003) (the “20% Contract”).

b. Wholesale Standard Offer Service Agreement between Blackstone Valley Electric Company, Eastern Edison Company, Newport Electric Corporation and Constellation Power Source, Inc. (dated December 21, 1998, and amended on January 27, 2003 and June 3, 2003) (the “36% Contract”).

c. Power Supply Agreement between The Narragansett Electric Company and Constellation Power Source, Inc. (dated October 5, 2001) (the “2001 Contract”).

d. Power Supply Agreement between Narragansett Electric Company and Constellation Power Source, Inc. (dated August 23, 2002, and amended August 23, 2002) (the “2002 Contract”).

17. The 20% Contract, the 36% Contract, and the 2001 Contract are governed by Massachusetts law, while the 2002 Contract is governed by Rhode Island law.

**B. Key Terms under the PPAs**

18. Under the PPAs, Constellation supplies (at wholesale) portions of NEC’s total Standard Offer Service requirements. Delivering “Wholesale Standard Offer Service” entails Constellation supplying NEC with the necessary electric “energy” and “capacity” required to satisfy those requirements.

19. “Capacity” (also known as “installed capacity” or “unforced capacity” or “UCAP”) as used in the PPAs serves as the functional equivalent of an option held by NEC to call forth more energy to meet increasing demand from its retail customers.

20. Requirements mandated by the New England Independent System Operator (“ISO New England”) and the New England Power Pool (“NEPOOL”) obligate NEC to procure “capacity” to supply “energy.” NEC satisfies these requirements by procuring supplies from Constellation, among others.

21. NEPOOL is a voluntary association of more than 200 participants in the New England bulk power system, created in 1971 to establish a central dispatch system for New England interstate power and to enhance system reliability. NEPOOL created a regional power grid that now includes more than 350 generating plants and more than 8,000 miles of transmission lines. NEPOOL has contracted with ISO New England, Inc. to operate and administer the New England transmission system and wholesale markets in Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont.

22. Standard Offer Service under the PPAs is firm all requirements electric power service, including installed capacity and reserves necessary to fulfill the requirements of those retail customers who contract with NEC for electric service.

23. The PPAs define Standard Offer Service as “firm all-requirements electric service . . . including . . . installed capability . . . necessary to fulfill all NEPOOL and ISO obligations as they may change from time to time associated with providing firm all requirements power to the Companies’ retail customers taking Standard Offer Service.” 20% Contract at 3; 36% Contract at 3. Constellation’s duties under the PPAs include delivering “energy” and “capacity” to NEC, which Constellation procures from upstream sources of generation.

24. The PPAs specify a stipulated base price plus a fuel adjustment factor covering all that Constellation delivers under the contracts. Under Article 3 of the 20% Contract and 36%

Contract, for example, Constellation promised to deliver the allocated portion of NEC's total aggregated load of customers taking Standard Offer Service and to satisfy all requirements and costs of performance. 20% Contract at 3-5; 36% Contract at 5-6.

25. The 2001 Contract likewise provides that Constellation shall deliver 100% of NEC's Standard Offer 2 Service requirements, and satisfy all requirements and costs of performing. 2001 Contract at 1, 4.

26. The 2002 Contract also follows this pattern. This contract requires Constellation to deliver the allocated portion of NEC's Wholesale Standard Offer 1 Service, and to satisfy all present and future requirements and costs for "Installed Capacity" required for the provision of Wholesale Standard Offer 1 Service and any related requirements, expenses or charges. 2002 Contract at 1.

**C. Constellation's Right to an Equitable Adjustment**

27. In each of the four PPAs, the parties expressly conditioned their duties on the regulatory landscape remaining unchanged from the date of contract execution. Rather than allocate the risk of intervening regulatory change to one party or the other, each PPA has a provision that binds NEC and Constellation to negotiate an equitable adjustment in the aftermath of any market rule or regulatory change that alters the economic benefits and burdens contemplated by the parties at the time of contracting.

28. Although the PPAs obligated Constellation to secure and pay for the "capacity" needed to satisfy the allocated share of NEC's Standard Offer Service load, the PPAs each contain the parties' promise to negotiate any equitable adjustments needed to address intervening changes in law or market rules that materially affect the costs and obligations to provide Standard Offer Service.

29. Specifically, the 20% and 36% Contracts provide that:

18(2) This Agreement is intended to comply with all NEPOOL Criteria, Rules and Standards ("Rules"). If, during the term of this Agreement, the Restated NEPOOL Agreement is terminated or amended in a manner that would eliminate or alter a Rule affecting a right or obligation of a Party hereunder, or if such a Rule is eliminated or altered by NEPOOL or the ISO, in a manner which materially affects the costs and obligations to provide Standard Offer Service, the Companies and Supplier shall meet to determine appropriate compensation to the affected Party.

18(3) In the event that the Standard Offer Service or the Terms and Conditions for Suppliers are terminated, amended or replaced by any governmental or regulatory agency having jurisdiction over the provision of Standard Offer Service in a manner which materially increases Suppliers' costs or obligations to provide Standard Offer Service or the Companies are prevented from recovering from customers taking Standard Offer Service the cost of electricity provided by Supplier, the Companies and Supplier shall meet to determine appropriate compensation to the negatively impacted Party. In the event that the Parties are not able to agree on the materiality of the increased cost or obligation or the amount to be reimbursed, Parties shall attempt to resolve the matter in accordance with Article 13.

20% Contract at 17; 36% Contract at 17.

30. Article 13 in turn provides, in relevant part, that:

Subject to Article 8(3), all disputes between the Companies and Supplier resulting from or arising out of performance under this Agreement shall be referred to a senior representative of the Companies with authority to settle, designated by the Companies, and a senior representative of Supplier with authority to settle, designated by Supplier, for resolution on an informal, face-to-face basis as promptly as practicable. The Parties agree that such informal discussion shall be conducted in good faith.... In the event the designated senior representatives are unable to resolve the dispute within thirty (30) days, or such other period as the Companies and Supplier may jointly agree upon, such dispute may be submitted to arbitration and resolved in accordance with the arbitration procedure set forth herein if the Companies and Supplier jointly agree to submit it to arbitration.

Ex. A at 14; Ex. B at 14.

31. The 2001 Contract likewise incorporates the parties' covenant to negotiate (and if necessary, arbitrate) any equitable adjustments needed to address changes that amend or terminate a Rule and that materially affect the costs and obligations to provide Standard Offer Service. Specifically, Article 14.2 reads:

This Agreement must comply with all NEPOOL market rules and/or operating procedures (“Rules”). If, during the term of this Agreement, the NEPOOL Agreement is terminated or amended in a manner that would eliminate or materially alter a Rule affecting a right or obligation of a Party hereunder, or if such a Rule is eliminated or materially altered by NEPOOL, the Parties agree to negotiate in good faith in an attempt to amend this Agreement to incorporate a replacement Rule (“Replacement Rule”). The intent of the Parties is that any such Replacement Rule reflect, as closely as possible, the intent and substance of the Rule being replaced as such Rule was in effect prior to such termination or amendment of the NEPOOL Agreement or elimination or alteration of the Rule. If the Parties are unable to reach agreement on such an amendment, the Parties agree to submit the matter to arbitration under the terms of Appendix B [sic] . . . and to seek a resolution of the matter consistent with the above stated intent.

2001 Contract at 20-21.

32. The reference in the 2001 Contract to Appendix B is an obvious typographical error. The correct reference should be to Section 15.2. The direction of Section 14.2 to “submit the matter to arbitration under *the terms* . . .” evidences the parties’ intent to submit equitable adjustment disputes to arbitration regardless of the amount in controversy. *See* 2001 Contract at 21 (emphasis added).

33. The 2002 Contract also includes the parties’ covenant to negotiate an equitable adjustment. Section 15.2 of the 2002 Contract reads:

If, during the term of this Agreement, any NEPOOL Rule [defined at page 3 of the 2002 Contract as all rules, operating procedures, agreements, manuals, protocols and tariffs adopted by NEPOOL/ISO, and accepted by FERC], Rhode Island statute or other applicable law is terminated or amended in a manner that would eliminate or materially (including economically) alter any rights or obligations of a Party hereunder, the Parties agree to negotiate in good faith to amend this Agreement so as to maintain, as closely as possible, the intent and substance of the allocation of rights and obligations contemplated hereunder. If after a period of thirty (30) days from the date on which a Party provides written notice to the other Party of the need to amend this Agreement, the Parties are unable to reach agreement on such an amendment, the Parties agree to submit the matter to arbitration under the terms of Section 16.2 (*regardless of the amount, if any, in controversy*) and to seek a resolution of the matter consistent with the above stated intent.

2002 Contract at 23-24 (emphasis added).

34. Section 16.2 provides, in relevant part, that:

Any dispute between the Company and Seller arising under or in connection with or relating in any way to this Agreement shall be referred to a senior representative of the Seller designated by the Seller and a senior representative of the Company designated by the Company for resolution on an informal basis as promptly as practicable. In the event the designated senior representatives are unable to resolve the dispute within ten (10) days, or such other period as the Parties may jointly agree upon . . . such dispute shall be submitted to arbitration and resolved in accordance with the arbitration procedure set forth in this Section 16.2. . . [T]he arbitrators shall be knowledgeable in electric utility matters, including wholesale power transactions and power market issues[.]

*Id.* at 24.

35. While Section 16.2 also states that the matter shall be submitted to arbitration “to the extent a reasonable estimate of the amount in dispute does not exceed two hundred fifty thousand dollars (\$250,000.00),” Section 15.2 makes this cap inapplicable when there is a law or regulatory change equitable adjustment dispute.

#### **E. The Settlement Agreement**

36. FERC regulates the wholesale market for electric energy and capacity, including NEC’s contracts with Constellation and the markets administered by ISO New England. At the time the parties contracted, the cost for supplying capacity was negligible.

37. In March 2006, however, all that changed. At the time, FERC issued an order accepting a Settlement Agreement that marked a significant shift in the regulatory landscape that was in place at the time that NEC and Constellation entered into the four PPAs at issue.

38. Under that Settlement Agreement, FERC approved a market rule change for “capacity” that replaced a market-based pricing regime with a new regime in which prices for capacity were set administratively during the Settlement Agreement “Transition Period” (December 1, 2006 to May 31, 2010), which coincides with the remaining term of the PPAs.

39. Constellation is not a “Settling Party” as that term is used in the Settlement Agreement and FERC Order approving it. NEC’s parent, National Grid USA—acting on behalf of itself and its subsidiaries—was a Settling Party.

40. Constellation never assented to modifying, abrogating, waiving or otherwise not deserting its equitable adjustment rights under the PPAs. At no time did Constellation say, do, or omit to say or do anything that reasonably would have induced NEC (or any other Party) to believe Constellation would forego any equitable adjustment rights Constellation enjoys under the PPAs.

41. Leading up to the Settlement Agreement, FERC found that companies supplying capacity were not receiving enough revenue to justify continued operation in a market-based rate regime or to foster development of the new generation needed for future demand. To address that problem, the Settlement Agreement imposes a regulatory regime intended to spur development of new electric generation to ensure reliable service in the future, which regime provides benefits of improved reliability to NEC and its ratepayers.

42. The change caused by the Settlement Agreement for the Transition Period profoundly alters the balance of economic benefits and burdens – rights and obligations – struck in the PPAs. That change mandates fixed prices for capacity suppliers in lieu of the negotiated terms allowed under the regulatory regime when the PPAs were executed. Costs of capacity billed by ISO New England to Standard Offer Service providers increase dramatically because the Settlement Agreement ordains a New England-wide fixed price negotiated by the capacity suppliers and other parties to the Settlement Agreement; not a price set by supply and demand.

43. Constellation received no consideration under the Settlement Agreement for any alleged promise to waive or not assert its rights under the PPAs.

44. FERC's approval of the Settlement Agreement does not abrogate, modify or waive the rights for an equitable adjustment Constellation enjoys under the PPAs.

45. Neither the FERC Order nor the explanatory statement filed in conjunction with applying for approval provide any support for NEC's contention that Section VIII(A) of the Settlement Agreement abrogated Constellation's rights under the PPAs to an equitable adjustment. The FERC Order and the explanatory statement contain no discussion of that provision and no indication of the consequence of the Settlement Agreement that NEC alleges.

46. The omission of any discussion in effect of the Settlement Agreement of the effect that NEC intended it to have on Constellation's rights under the PPAs was wrongful and done deliberately and with unclean hands so as to interfere with or denigrate Constellation's contractual and economic interests.

47. The Settlement Agreement explicitly does *not* prejudice contractual rights of parties:

Neither support for this Settlement Agreement, nor the Term Sheet relating hereto, nor the submission of this Settlement Agreement and the concurrence in, *or failure to comment on*, the described settlement shall constitute an admission by any Settling Party that any allegation or contentions in Docket Nos. ER03-563-030 and ER03-563-055 were true or valid or that any Settling Party had acted consistent with, or contrary to, contract provisions, the FPA, or any other federal or state law or regulation.

\* \* \*

FERC's approval of this Settlement Agreement shall not constitute approval of or precedent regarding any principle or issue in Docket Nos. ER03-563-030 and ER03-563-055 before the FERC.

Settlement Agreement at 5-6 (emphasis added).

48. The Settlement Agreement does not, under any reasonable reading, provide that Constellation waives its right to an equitable adjustment under the PPAs or agrees not to prosecute such rights.

49. In support of its claim to the contrary, NEC has cited the following provision:

The current UCAP products shall be retained for the period commencing on December 1, 2006 and ending on May 30, 2010 (the "Transition Period") as provided for in Part VIII.I. Payments will be made to UCAP entitlement holders, and made by UCAP obligation holders including wholesale standard offer suppliers in Rhode Island as under the current Market Rules and tariffs; it being understood that the agreement of wholesale standard offer suppliers in Rhode Island to make UCAP payments is contingent upon the agreement of the state of Rhode Island utility regulatory authorities to support the settlement.

*Id.* at 46. The FERC Order explained that "obligation holders" means "load-serving entities," like NEC.

50. That clause, Section VIII.A., however, merely provides that, in Rhode Island, the obligation of load-serving entities to pay UCAP entitlement holders will be satisfied by having wholesale standard offer service suppliers make the payment. The clause addresses the party from whom UCAP entitlement holders may expect payment as it concerns Rhode Island utilities. It does not address in any way specific contractually negotiated equitable adjustment rights that exist between a Rhode Island load-serving entity and a particular wholesale supplier.

**F. Constellation Duly Invoked the Right to an Equitable Adjustment**

51. In light regulatory changes made by the Settlement Agreement, and the equitable adjustment provisions in the PPAs, Constellation invoked its right to an equitable adjustment by a letter to NEC, dated August 1, 2006.

52. Constellation's August 1, 2006 letter did not assert any demand to specific remuneration, but rather properly exercised Constellation's right under each of the PPAs to discuss with NEC the appropriate adjustments needed.

53. Rather than negotiate in good faith, agree to equitable adjustment as required by the clear language of the PPAs, or submit this dispute to arbitration as required by the PPAs, NEC instead sued Constellation in this Court.

### **COUNTERCLAIMS**

#### **Count I** **Demand for Arbitration**

54. Constellation incorporates each and every allegation in Paragraphs 1 through 53 of the Counterclaim as if repeated here.

55. Some or all of the PPAs require mandatory arbitration of the instant dispute over the need and measure of an equitable adjustment due to the changes in regulatory rules and laws implemented by the Settlement Agreement.

56. Pursuant to the Federal Arbitration Act (“FAA”), 9 U.S.C. § 4, the Court should compel NEC to arbitrate its claims against Constellation.

57. Because any remaining non-arbitrable issues are so related to and intertwined with those subject to arbitration, pursuant to the FAA, 9 U.S.C. § 3, the Court should stay the proceedings of any nonarbitrable claims pending the outcome of the arbitration proceedings.

#### **Count II** **Declaratory Judgment** **(Equitable Adjustment)**

58. Constellation incorporates each and every allegation in Paragraphs 1 through 57 of the Counterclaim as if repeated here.

59. There is an actual controversy as to whether Constellation is entitled to an equitable adjustment under the four PPAs.

60. Under the language of the four PPAs, Constellation is entitled to an equitable adjustment due to the intervening regulatory changes effectuated by the Settlement Agreement which regulatory changes (among other things) have altered the market for capacity from a free market to one in which prices are fixed by regulatory order.

61. Pursuant to the Declaratory Judgment Act, 28 U.S.C. § 2201, the Court should declare that Constellation is entitled to an equitable adjustment under the four PPAs and that NEC breached those agreements by failing to negotiate or agree to such an equitable adjustment.

**Count III**  
**Breach of Contract**

62. Constellation incorporates each and every allegation in Paragraphs 1 through 61 of the Counterclaim as if repeated here.

63. Under the language of the four PPAs, Constellation is entitled to an equitable adjustment due to the intervening regulatory changes in the Settlement Agreement that have altered the regulatory landscape, the economic costs to Constellation, and the rights and obligations of Constellation and NEC.

64. NEC has breached the PPAs by refusing to enter into good faith settlement discussions regarding the need for an equitable adjustment to the contracts.

65. NEC has breached the PPAs by refusing to arbitrate the dispute regarding the need for an equitable adjustment to the contracts.

66. NEC has breached the PPAs by refusing to agree to an equitable adjustment to the contracts after the regulatory and law changes implemented by the Settlement Agreement.

67. Constellation has and will suffer damages as a direct and proximate result of NEC's breach of the PPAs, for which NEC is liable.

68. This Court should find that NEC has materially breached the four PPAs, and that Constellation has suffered and will continue to suffer damages as a direct and proximate result of this material breach.

**Count IV**  
**Declaratory Judgment**  
**(ASM/ PPAs)**

69. Constellation incorporates each and every allegation in Paragraphs 1 through 68 of the Counterclaim as if repeated here.

70. An actual controversy exists as to whether the costs Constellation incurred and is incurring as a result of the implementation of ASM Phases I and II, including transition period costs, entitle Constellation to additional compensation under the PPAs.

71. Under the language of the four PPAs, Constellation is entitled to additional compensation as a result of the implementation of the ASM Phases I and II, including transition period costs.

72. Pursuant to the Declaratory Judgment Act, 28 U.S.C. § 2201, the Court should declare that each of the PPAs entitle Constellation to recover an equitable adjustment for costs attributable to the implementation of ASM Phases I and II.

**Count V**  
**Breach of Contract**  
**(ASM/ PPAs)**

73. Constellation incorporates each and every allegation in Paragraphs 1 through 72 of the Counterclaim as if repeated here.

74. Under the language of the four PPAs, Constellation is entitled to additional compensation as a result of the implementation of the ASM Phases I and II, including transition period costs.

75. To date, however, NEC has refused to negotiate in good faith regarding that dispute, to arbitrate that dispute, or to provide additional compensation to Constellation as required by the terms of the four PPAs.

76. NEC has breached the PPAs by refusing to enter into good faith settlement discussions regarding the need to provide Constellation with additional compensation as a result of the implementation of the ASM Phases I and II, including transition period costs.

77. NEC has breached the PPAs by refusing to arbitrate the dispute regarding the need to provide Constellation with additional compensation as a result of the implementation of the ASM Phases I and II, including transition period costs.

78. NEC has breached the PPAs by refusing to provide Constellation with additional compensation as a result of the implementation of the ASM Phases I and II, including transition period costs.

79. Constellation has and will suffer damages as a direct and proximate result of NEC's breach of the PPAs, for which NEC is liable.

80. This Court should find that NEC has materially breached the four PPAs, and that Constellation has suffered and will continue to suffer damages as a direct and proximate result of this material breach.

**Count VI**  
**Declaratory Judgment**  
**(Waiver)**

81. Constellation incorporates each and every allegation in Paragraphs 1 through 80 of the Counterclaim as if repeated here.

82. An actual controversy exists as to whether the Settlement Agreement affects Constellation's rights under its PPAs with NEC, including its rights to equitable adjustments triggered by particular regulatory changes.

83. Constellation did not waive its rights to an equitable adjustment or to recover Transition Period UCAP costs as a result of either the Settlement Agreement or any of its knowledge or conduct related to that agreement.

84. The Settlement Agreement does not bar, preclude, waive or otherwise denigrate Constellation's right under the four PPAs to an equitable adjustment as a result of the regulatory changes effectuated pursuant to FERC's approval of the Settlement Agreement.

85. Pursuant to the Declaratory Judgment Act, 28 U.S.C. § 2201, the Court should declare that the Settlement Agreement has no effect on Constellation's right to equitable adjustments under the PPAs, and that each of the PPAs entitles Constellation to an equitable adjustment to be compensated for regulatory increase in the costs of capacity.

**Count V**  
**Quasi-Contract; Unjust Enrichment; *Quantum Meruit***

86. Constellation incorporates each and every allegation in Paragraphs 1 through 85 of the Counterclaim as if repeated here.

87. In the event that the four PPAs do not provide Constellation with the right to an equitable adjustment, then Constellation is nonetheless entitled to relief under quasi-contract, unjust enrichment, or *quantum meruit*.

88. Constellation has conferred a benefit on NEC by continuing to provide the level of UCAP required by ISO New England despite the increase in cost to Constellation and despite the impossibility of performing the PPAs in accordance with the original intent of those contracts.

89. NEC has appreciated the benefit by continuing to supply power to its Rhode Island customers without providing additional compensation to Constellation.

90. NEC is unjustly enriched to the extent of the value of the UCAP received in excess of its payments to Constellation.

91. NEC is liable to Constellation under the doctrines of quasi-contract, unjust enrichment and/or *quantum meruit* for the value of the benefit Constellation has thus conferred on NEC and will continue to confer until termination of the PPAs.

**PRAYER FOR RELIEF**

WHEREFORE, Constellation requests that the Court enter an order and judgment in favor of Constellation:

- (i) compelling NEC to arbitrate this dispute and staying all other proceedings pending that arbitration;
- (ii) declaring that Constellation is entitled to an equitable adjustment under the four PPAs and finding that NEC has breached the four PPAs;
- (iii) dismissing all claims in NEC's Complaint with prejudice;
- (iii) awarding Constellation such damages as may be proven at trial;
- (iv) awarding Constellation all its reasonable costs;
- (v) awarding Constellation its reasonable attorneys' fees; and
- (vi) awarding such further relief as the Court deems just and proper

Dated: January 15, 2008

Respectfully Submitted,

/s/ Stacey P. Nakasian

Stacey P. Nakasian, Esq. (Bar No. 5069)  
DUFFY SWEENEY & SCOTT, LTD.  
One Turks Head Place, Suite 1200  
Providence, RI 02903  
Tel: (401) 455-0700  
Fax: (401) 455-0701

Kenneth W. Irvin (DC Bar ID #439395)  
Paul Thompson  
Teresa M. Goody  
MCDERMOTT WILL & EMERY LLP  
600 13th Street, N.W.  
Washington, DC 20005-3096  
Tel: (202) 756.8116  
Fax: (202) 756.8087  
Email: kirvin@mwe.com

*Attorneys for Defendant  
Constellation Energy Commodities Group, Inc.*

**CERTIFICATE OF SERVICE**

I hereby certify that on January 15, 2008 the foregoing *Answer of Constellation Energy Commodities Group, Inc.* was filed electronically with the Clerk of the Court for the District of Rhode Island using the ECF System which will send notification to the following registered participants of the ECF System as listed on the Court's Notice of Electronic Filing:

Gerald J. Petros  
Robin Main  
Hinckley, Allen & Snyder LLP  
50 Kennedy Plaza, Suite 1500  
Providence, RI 02903

*Counsel for The Narragansett Electric Company*

Leo J. Wold, Esq.  
Richard Woolley, Esq.  
Rhode Island Attorney General  
150 South Main Street  
Providence, RI 02903

*Counsel for State of Rhode Island and Providence Plantations and  
the Rhode Island Division of Public Utilities and Carriers*

/s/ Stacey P. Nakasian

Stacey P. Nakasian

*Attorney for Defendant  
Constellation Energy Commodities Group, Inc.*



to intervene and to join claim. A copy of the State's proposed Complaint is attached as Exhibit A to the memorandum of law in support of the State's motion.

Counsel for the State has contacted counsel for Narragansett Electric and Constellation. Narragansett Electric does not object to the State's intervention in this proceeding. At this stage, Constellation "is not in position to consent" to the State's motion.

Respectfully submitted,

STATE OF RHODE ISLAND  
PROVIDENCE PLANTATIONS,  
and the RHODE ISLAND DIVISION OF  
PUBLIC UTILITIES AND CARRIERS  
By their attorney,

PATRICK C. LYNCH  
ATTORNEY GENERAL

/s/ Leo J. Wold

/s/ Richard B. Woolley

---

Leo J. Wold, # 3613

Richard B. Woolley, # 1452

150 South Main Street

Providence, RI 02903

Tel: 401-274-4400, ext. 2218

Fax: 401-222-3016

[LWold@riag.ri.gov](mailto:LWold@riag.ri.gov)

[RWoolley@riag.ri.gov](mailto:RWoolley@riag.ri.gov)

Dated: January 9, 2007

**CERTIFICATION**

I certify that on January 9, 2007, a copy of the within motion was filed electronically and served by mail on anyone unable to accept electronic filing. Notice of this filing will be sent by e-mail to all parties by operation of the Court's electronic filing as indicated on the Notice of Electronic Filing. Parties may access this filing through the Court's CM/ECF System.

/s/ Leo J. Wold

/s/ Richard B. Woolley

---

Leo J. Wold, # 3613

Richard B. Woolley, # 1452

150 South Main Street

Providence, RI 02903

Tel: 401-274-4400, ext. 2218

Fax: 401-222-3016

[LWold@riag.ri.gov](mailto:LWold@riag.ri.gov)

[RWoolley@riag.ri.gov](mailto:RWoolley@riag.ri.gov)



A copy of the proposed Complaint is annexed hereto as Exhibit A. For the reasons expressed below, the State respectfully requests that the Court grant its motion to intervene as a matter of right pursuant to Fed. R. Civ. P. 24(a), or, alternatively, to intervene permissively pursuant to Fed. R. Civ. P. 24(b), and to allow the joinder of Count III pursuant to Fed. R. Civ. P. 18(a).

**II. THE STATE IS ENTITLED TO INTERVENE AS A MATTER OF RIGHT.**

In order to intervene as a matter of right, a movant must satisfy four criteria: (A) the application must be timely; (B) the movant must claim an interest relating to the property or transaction which is the subject of the action; (C) the movant must be so situated that the disposition of the action may as a practical matter impair or impede his ability to protect that interest; and (D) the applicant must show its interest will not be adequately represented by the existing parties. E.g., Travelers Indem. Co. v. Dingwell, 884 F.2d 629, 637 (1<sup>st</sup> Cir. 1989). Each of these factors is readily satisfied by even the most cursory examination of the Complaint, the proposed Complaint and the motions and legal memoranda that have been filed to date with the Court.

**A. The State's Application Is Timely.**

The State's motion to intervene is clearly timely. The significant pleadings that have been filed to date are the Complaint, the defendant's motion to dismiss, or in the alternative, motion to compel arbitration and the plaintiff's response to the aforementioned motion to dismiss, along with supporting memoranda of law. No discovery has been undertaken, and due to the early nature of the intervention request, neither the plaintiff nor the defendant will suffer any prejudice if the State's motion is

granted. The State's application seeking intervention as a matter of right, therefore, is timely.

**B. The State Possesses An Interest That Is The Subject Of The Pending Action.**

Where persons or entities are directly impacted or affected by a law, they are permitted to intervene as a matter of right to defend their financial interest with respect to the law. See New York Public Interest Research Group, Inc. v. Regents, 516 F.2d 350, 352 (2d Cir. 1975) (pharmacists and their association were permitted to intervene as of right to defend their financial interest with respect to a state regulation prohibiting the advertisement of prescription drug prices that was under attack by a consumers' lawsuit). This is all the more true when the intervening party is directly involved in the drafting and passage of the new law that is being challenged. See Michigan State AFL-CIO v. Miller, 103 F.3d 1240, 1245-1247 (6<sup>th</sup> Cir. 1997) (where Chamber was a vital player in the political process that led to the adoption of legislation, intervention as a matter of right was appropriate).

In 2004, the Independent System Operator ("ISO New England") proposed a locational installed capacity ("LICAP") market. Under this market, ISO New England proposed to allocate capacity payments to electricity generators by geographic zones (*i.e.* by location) based on certain formula that were designed to provide an incentive for the creation of generation capacity. State regulatory bodies, public utilities and municipal load serving entities, and many others objected to the LICAP market for, among other reasons, it was estimated that imposition of the market would cost New England electric ratepayers many hundreds of millions, if not several billion dollars, without providing adequate capacity or reliability. As a consequence of this vehement opposition, FERC

postponed the implementation of the LICAP market in the proceeding then pending before the agency, Devon Power LLC, et al. Docket No. ER03-563-03 & ER03-563-055, and gave the parties an additional opportunity to pursue a settlement.

In or about the Fall of 2005 and into early 2006, regulatory and consumer representatives of the six New England States, generators, transmission owners, power suppliers, among others, negotiated a settlement agreement (the “Agreement”) that proposed the adoption of a Forward Capacity Market (“FCM”), as an alternative to the LICAP market. The Agreement was the end product of a series of over 30 settlement conferences and negotiations, involving 115 parties, taking place over about a four-month period with the active participation and involvement of Administrative Law Judge Lawrence Brenner. The Division, Narragansett Electric’s parent, National Grid USA, on behalf of itself and its subsidiaries that were intervenors in the proceeding, and Constellation and FPL Energy, LLC, an affiliate of Florida Power & Light, which was pursuing a merger with Constellation, participated in these conferences and negotiations, among other settlement participants.

During the settlement conferences and negotiations, the State became a “swing” settlement participant. Without the State’s agreement to become a Settling Party, neither ISO New England would recommend the FCM to FERC, nor would FERC approve the FCM. Without the State’s agreement to become a Settling Party, the FCM would not have been created in New England, and Rhode Island standard offer wholesale suppliers (of which Constellation was one), among others, would have faced or incurred continued vigorous opposition to the proposed LICAP market, endless litigation and substantial monetary detriment. Settlement participants, including Rhode Island standard offer

wholesale suppliers, therefore, included language (*i.e.*, Section VIII(A)) in the proposed Agreement to induce the State to become a Settling Party to the Agreement. Section VIII(A) provides as follows:

The current UCAP products shall be retained for the period commencing on December 1, 2006 and ending on May 30, 2010 (the “Transition Period”) as provided for in Part VIII.I. Payments will be made to UCAP entitlement holders including wholesale standard offer suppliers in Rhode Island as under the current Market Rules and tariffs; it being understood that the agreement of wholesale standard offer suppliers in Rhode Island to make UCAP payments is contingent upon the agreement of the state of Rhode Island utility regulatory authorities to support the settlement.

The Agreement, including Section VIII(A), was filed on March 6, 2006 and approved by a FERC Order dated June 16, 2006 (the “Order”). The clear and unequivocal language of Section VIII(A) reflects settlement participants’, including Rhode Island standard offer wholesale suppliers’, understanding that they would not be able seek or obtain the recovery of Transition Period UCAP Costs or any other similar costs from Narragansett Electric and/or Rhode Island’s electric ratepayers.

Count I of the Complaint seeks a declaration that “Section VIII(A) . . . preclude[s] Constellation from obtaining any additional compensation attributable to market changes, including compensation for the Transition Period UCAP Costs.” Count II seeks a ruling based on a pleading that Constellation “waived its right to recover Transition Period UCAP Costs” by, among other things, participating in the negotiation of the Agreement, knowing that “Rhode Island’s support of the Settlement Agreement was based upon the understanding that the Settlement Agreement precluded Constellation from either seeking or recovering such costs,” and Constellation’s failure to object to Section VIII(A).

The first two Counts of the Complaint of Narragansett Electric, along with associated averments (*e.g.*, Paras. 20, 21, 22, 23-29) are premised upon language (*i.e.*, Section VIII(A)) given by Rhode Island standard offer wholesale suppliers to, and received by the State in consideration of, the State's agreement to become a Settling Party. The Agreement was executed by the State, National Grid USA, on behalf of itself and subsidiaries that were intervenors in the proceeding, and by FPL Energy LLC, which was pursuing a merger with Constellation, among others, and approved by the Order. Pursuant to federal law, the Agreement and Order are binding upon Constellation.

As the Agreement contains language that inures directly to the benefit of the State and Rhode Island's electric ratepayers, the State and its electric ratepayers possess a direct and substantial interest in enforcing Section VIII(A) and ensuring that Constellation may not recover Transition Period UCAP Costs or any other similar costs from Narragansett Electric and Rhode Island's electric ratepayers. The Agreement and Order, therefore, "directly affect the State and its electric ratepayers." See New York Public Interest Research Group, 516 F.2d at 352. The substantial direct interest possessed by the State is all the more present where, as here, the State participated in the negotiations that led to the inclusion Section VIII(A) in the Agreement, and Section VIII(A) was added to the Agreement for the express purpose of protecting Rhode Island and its ratepayers. See Michigan State AFL-CIO, 103 F.3d at 1247. It follows that the State possesses a substantial interest that is the subject of the pending action.

**C. Disposition Of The Pending Action Without The State's Presence Will Impair Or Impede The State's Ability To Protect Its Interests.**

In order to satisfy the impairment criterion for Rule 24(a) intervention, federal courts have held that the potential economic harm to a would-be intervenor warrants serious consideration in the impairment inquiry. See Conservation Law Found. v. Mosbacher, 966 F.2d 39, 43 (1<sup>st</sup> Cir. 1992). Thus, business groups possess an interest in challenging a law that could significantly change the conduct of their business. E.g., New York Pub. Interest Research Group, 516 F.2d at 352.

In the case at bar, the State possesses legitimate claims based on the Order and Settlement, as well as Constellation's action and inaction, that Constellation is neither entitled to make demand, nor entitled to recover Transition Period UCAP costs or any similar costs from Narragansett Electric and Rhode Island's electric ratepayers. If the Court were to dispose of the pending action in favor of Constellation without the State's presence, the State's and its electric ratepayers' interest in enforcing their rights under the Order and Agreement would be completely impaired. The State and Rhode Island's electric ratepayers would be bound by the Court's adverse rulings without having had the opportunity to assert their rights that the Agreement and Order serve as a bar to Constellation's recovery of Transition Period UCAP costs or any similar costs from Narragansett Electric. Rhode Island electric ratepayers, then, would be unjustly burdened with an increase in electric rates currently estimated by Constellation at between \$100 and \$150 million. This economic harm is immediate and substantial. Disposition of the pending action without the State's presence would indeed impact the State's ability to protect its interests and that of its electric ratepayers.

**D. The State's Interests Cannot Be Adequately Represented  
By The Existing Parties.**

An applicant for intervention need only make a minimal showing that the representation by the existing parties likely will prove inadequate. Trbovich v. United Mine Workers, 404 U.S. 528, 538 n.10 (1972). An analysis of “inadequacy” requires a consideration of the strength of the interests that the would-be intervenors present and the tests of inadequacy may vary with the strength of those interests. Main v. Dir., United States Fish & Wildlife Serv., 262 F.3d 13, 20 (1<sup>st</sup> Cir. 2001). Courts may require very little “inadequacy” if the would be intervenors have significant interests at stake. Dagget v. Comm'n on Governmental Ethics and Election Practices, 172 F.3d 104, 113-114 (1<sup>st</sup> Cir. 1999).

Narragansett Electric legitimately seeks a declaratory judgment that Constellation is precluded from recovering Transition Period UCAP Costs or any similar costs through its own agreements with Constellation (the PPAs) and the Agreement, to which it was also a signatory, and the Order. Although Narragansett Electric will be required to make a retail filing with the Rhode Island Public Utilities Commission to recover any increase in costs associated with its dispute with Constellation, as long as these costs are reasonably and prudently incurred, they will be borne by Rhode Island's electric ratepayers. Thus, even though Narragansett Electric is a Settling Party and may enforce the Agreement and Order against Constellation, because the company may be able to obtain rate relief, Narragansett Electric does not possess an incentive as strong as the State to ensure that the Agreement and Order are enforced against Constellation.

Just as importantly, Section VIII(A) of the Agreement and Order bars Constellation and other Rhode Island standard offer wholesale suppliers from recovering Period UCAP Costs or any similar costs, and was included in the Agreement in exchange for the State's agreement to enter into the Agreement. The principal right created by Section VIII(A), thus, inures to the benefit of Rhode Island's electric ratepayers. Only the State can truly represent their interests adequately.

Lastly, that Narragansett Electric cannot adequately represent the State's interest appears within the four corners of the proposed Complaint. The State possesses a claim (Count III) that Narragansett Electric, has not, and cannot assert against Constellation because it was the State that reasonably relied on Rhode Island standard offer wholesale suppliers' and Constellation's conduct to its detriment.

The State's interest in intervening in this matter, then, is great, and none of the existing parties can represent the State's interests in the pending proceeding. The minimal showing of "inadequacy" that is required for Rule 24(a) intervention is more than satisfied in the case at bar.

**III. IN THE ALTERNATIVE, THE STATE SHOULD BE PERMITTED TO INTERVENE PERMISSIVELY.**

If this Court were to find that the State should not be permitted to intervene as of right, the Court should still permit the State to intervene permissively. Fed. R. Civ. P. 24(b) provides that permissive intervention may be allowed "when the applicant's claim or defense in the main action have a question of law or fact in common." Permissive intervention is discretionary with the Court. However, the primary consideration in deciding whether or not to grant such intervention is whether the intervention would

unduly “delay or prejudice the adjudication or rights of the original parties.” See Dagget, 172 F.3d at 113-114.

The Court should allow the State to intervene in this action because common questions of law and fact abound, and the State, like Narragansett Electric, is seeking to bar Constellation from recovery of Transition Period UCAP costs or any similar costs under the Agreement and Order. As shown, the State’s participation in this proceeding will not delay or prejudice the rights of Narragansett Electric or Constellation. Moreover, as the State was intimately involved in the negotiations and conferences that led to the consummation of the Agreement, the State’s participation in fact could assist the Court in expediting the adjudication of the issues to be decided. Intervention, on a permissive basis, therefore, is appropriate.

#### **IV. THE STATE’S REQUEST TO JOIN COUNT III IS APPROPRIATE.**

Under Fed. R. Civ. P. 18(a), “a party asserting a claim to relief as an original claim . . . may join, either as independent or as alternate claims, as many claims, legal equitable, or maritime, as the party has against an opposing party.” Here, assuming the Court grants the State’s request to intervene as a matter of right or permissively, the Court should also permit the State to join Count III of its proposed Complaint to the two “original claims” to which it has intervened.

Although joinder of claims under Rule 18(a) is permissive, the policy underpinning the rule—to avoid piecemeal litigation—is “toward entertaining the broadest possible scope of action consistent with fairness to the parties; joinder of claims, parties and remedies is strongly encouraged.” United Mine Workers of America v. Gibbs, 383 U.S. 715, 724 (1966). According to one authority, the only restriction to the

rule arises when joinder would result in great unfairness or prejudice to a party. MGD Graphic Systems, Inc. v. A & A Bindery, Inc., 76 F.R.D. 66, 68 (E.D. Pa. 1977). Since Rule 18(a) deals only with the scope of joinder at the pleading stage, the rule should permit the “joinder of practically anything, and the court, in its discretion can make an order for the separate trial of any matter which can be more conveniently tried that way.” 6A Wright, Miller & Kane, Federal Practice and Procedure § 1581 at 520 n.12 (1990) (quoting Sunderland The New Federal Rules, 1938, 45 W.Va.LQ. 5, 13).

In the case at bar, the State alleges in Count III of the proposed Complaint that Constellation is estopped from recovering Transition Period UCAP costs or any similar costs by the Agreement and Order and the company’s own conduct. The Count arises from the same transaction or occurrence as Counts I and II of the Complaint. The pending action is still in the pleading stage, and Constellation would not incur prejudice of any kind as a result of the joinder of Count III to Counts I and II of the Complaint. Joinder of Count III, therefore, is appropriate pursuant to Fed. R. Civ. P. 18(a).

**V. CONCLUSION**

For the foregoing reasons, the State respectfully requests that the Court grant its motion to intervene and to join claim.

Respectfully submitted,

STATE OF RHODE ISLAND  
PROVIDENCE PLANTATIONS and  
the RHODE ISLAND DIVISION OF  
PUBLIC UTILITIES AND CARRIERS  
By their attorney,

PATRICK C. LYNCH  
ATTORNEY GENERAL

Dated: January 9, 2007

/s/ Leo J. Wold

/s/ Richard B. Woolley

---

Leo J. Wold, # 3613

Richard B. Woolley, # 1452

150 South Main Street

Providence, RI 02903

Tel: 401-274-4400, ext. 2218

Fax: 401-222-3016

[LWold@riag.ri.gov](mailto:LWold@riag.ri.gov)

[RWoolley@riag.ri.gov](mailto:RWoolley@riag.ri.gov)

**CERTIFICATE OF SERVICE**

I certify that on January 9, 2007, a copy of the within memorandum of law was filed electronically and served by mail on anyone unable to accept electronic filing. Notice of this filing will be sent by e-mail to all parties by operation of the Court's electronic filing as indicated on the Notice of Electronic Filing. Parties may access this filing through the Court's CM/ECF System.

/s/ Leo J. Wold

/s/ Richard B. Woolley

---

Leo J. Wold, # 3613

Richard B. Woolley, # 1452

150 South Main Street

Providence, RI 02903

Tel: 401-274-4400, ext. 2218

Fax: 401-222-3016

[LWold@riag.ri.gov](mailto:LWold@riag.ri.gov)

[RWoolley@riag.ri.gov](mailto:RWoolley@riag.ri.gov)

UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF RHODE ISLAND

---

THE NARRAGANSETT ELECTRIC )  
COMPANY, )  
Plaintiff )  
STATE OF RHODE ISLAND AND )  
PROVIDENCE PLANTATIONS )  
and the RHODE ISLAND DIVISION )  
OF PUBLIC UTILITIES AND )  
CARRIERS )  
Intervenor-Plaintiffs, )  
v. )  
CONSTELLATION ENERGY )  
COMMODITIES GROUP, INC., )  
Defendant. )

---

C.A. NO. 06-404S

**OBJECTION OF THE DIVISION OF PUBLIC UTILITIES  
AND CARRIERS AND STATE OF RHODE ISLAND AND  
PROVIDENCE PLANTATIONS TO CONSTELLATION’S  
SUGGESTION OF THE ABSENCE OF JURISDICTION  
AND/OR MOTION FOR STAY PENDING APPEAL**

The State of Rhode Island and Providence Plantations and the Rhode Island Division of Public Utilities and Carriers (collectively referred to herein as the “State”) object to the Suggestion of the Absence of Jurisdiction and/or Motion for Stay Pending Appeal of Constellation Energy Commodities Group, Inc. (“Constellation”), request this Court to deny Constellation’s motion for stay pending appeal, and enter such other relief as the Court deems just and proper to effectuate the adjudication of the State’s Complaint forthwith.

In support of its objection, the State submits the accompanying memorandum of law.

Respectfully submitted,

STATE OF RHODE ISLAND AND  
PROVIDENCE PLANTATIONS,  
and the RHODE ISLAND DIVISION OF  
PUBLIC UTILITIES AND CARRIERS  
By their attorney,

PATRICK C. LYNCH  
ATTORNEY GENERAL

/s/ Leo J. Wold

/s/ Richard B. Woolley

---

Leo J. Wold, # 3613

Richard B. Woolley, # 1452

150 South Main Street

Providence, RI 02903

Tel: 401-274-4400, ext. 2218

Fax: 401-222-3016

LWold@riag.ri.gov

RWoolley@riag.ri.gov

Dated: January 28, 2008

**CERTIFICATION**

I certify that on January 28, 2008, a copy of the within objection was filed electronically and served by mail on anyone unable to accept electronic filing. Notice of this filing will be sent by e-mail to all parties by operation of the Court's electronic filing as indicated on the Notice of Electronic Filing. Parties may access this filing through the Court's CM/ECF System.

/s/ Leo J. Wold

/s/ Richard B. Woolley

---

Leo J. Wold, # 3613

Richard B. Woolley, # 1452

150 South Main Street

Providence, RI 02903

Tel: 401-274-4400, ext. 2218

Fax: 401-222-3016

LWold@riag.ri.gov

RWoolley@riag.ri.gov



## I. ARGUMENT

### A. CONSTELLATION HAS NOT PRESENTED COMPELLING REASONS TO STAY THE STATE'S COMPLAINT.<sup>1</sup>

When a district court is confronted with the issue of whether or not to grant a discretionary stay with respect to non-arbitrable claims, “arbitration and federal litigation should proceed simultaneously absent compelling reasons to stay the litigation.” See Chang v. Lin, 824 F.2d 219, 223 (2d Cir. 1987) (allowing arbitration and federal litigation to proceed simultaneously in the context of ’33 Act claims); Tedeschi v. Applied Concepts, 2007 WL 184734 (N.D. Ohio 2007) (discretionary stay denied where non-arbitrable claims were outside the scope of limited arbitration clause). Stated another way, there is a “heavy presumption” against the deferral of non-arbitrable claims. Chang, 824 F.2d at 223. See also Pompano-Windy City Partners, Ltd., 698 F. Supp. 504, 520 (S.D.N.Y. 1988). This principle is all the more true when: (i) the independent, non-arbitrable claim is brought on behalf of a “sovereign entity,” Montauk Oil Transportation Corp. v. Steamship Mutual Underwriting Association Ltd., 859 F. Supp. 669, 676 (S.D.N.Y. 1994), (ii) “the entity is not a party to the arbitration agreement,” Sierra Rutile Limited v. Katz, 937 F.2d 743, 750 (2d Cir. 1991); Montauk Oil, 859 F. Supp. at 679; and, (iii) “and the sovereign’s claims involve the vindication of a public right of broad social importance.” Montauk Oil, 859 F. Supp. at 679 (vindication of pollution free waterways). See also Sam Reisfeld & Son Import Company v. S. A. Eteco, 530 F.2d 679, 681 (5th Cir. 1976) (federal antitrust claims should proceed to trial since such claims generally are not arbitrable); Horne v. New England Patriots Football Club,

---

<sup>1</sup> The term “Complaint,” as used herein, refers to the State’s Complaint that was filed with the Court on December 12, 2007.

Inc., 489 F. Supp. 465, 470 (D. Mass. 1980) (when the arbitration proceeding cannot vindicate an individual's independent statutory right protecting against age discrimination, a discretionary stay is improper).

**1. The State's Claims Are Not Subject To Arbitration.**

Under the aforementioned standard of review, Constellation has not presented the Court with compelling circumstances to stay the Complaint pending its interlocutory appeal. Most significantly, the State's claims are not subject to arbitration. No contract exists between Constellation and the State upon which Constellation can assert a right to arbitrate. Absent such a contractual right, Constellation simply does not possess the right to compel arbitration of any of the claims contained in the State's Complaint. Sierra Rutile, 937 F.2d at 750; Citrus Marketing Board of Israel v. J. Lauritzen A/S, 943 F.2d 220, 225 (2d Cir. 1991); IDS Live Insurance Co. v. Sun America, Inc., 103 F.3d 524, 529 (7th Cir. 1997); In Re: Talbott Bigfoot, Inc., 887 F.2d 611, 614 (5th Cir. 1989); Montauk Oil, 859 F. Supp. at 676. Constellation's allegation to the contrary on Page 6 of its memorandum of law is without merit.

**2. Proceeding To Adjudicate The State's Claims Will Vindicate An Important Public Right Belonging To The State of Rhode Island And Its Electric Ratepayers.**

Moreover, the State of Rhode Island is a sovereign entity, which possesses a vital interest in vindicating Rhode Island electric ratepayers' rights under Section VIII(A) of the Settlement<sup>2</sup> and Order<sup>3</sup> of the Federal Energy Regulatory Commission ("FERC") as

<sup>2</sup> The Settlement Agreement ("Settlement") was filed on March 6, 2006 in Devon Power LLC, et al., Docket Nos. ER03-563-030 & ER03-563-055.

<sup>3</sup> The Order Accepting Proposed Agreement ("Order") was issued by FERC on June 16, 2006.

soon as possible. As the Court will recall, the process that led to the consummation of the Settlement and issuance of the Order involved regulatory and consumer representatives of the six New England States, generators, transmission owners, and power suppliers, among others. The Settlement, which proposed the adoption of a Forward Capacity Market (“FCM”) as an alternative to the Locational Installed Capacity (“LICAP”) market, possesses region-wide economic impact, estimated at well over a billion dollars, was the product of over 30 formal settlement conferences and negotiations involving roughly 115 parties, as well as the active participation of Administrative Law Judge Lawrence Brenner, and ultimately FERC itself.

During the course of the conferences and negotiations that transpired between the settlement process participants, the State became a “swing” settlement participant. As such, in consideration of the State’s agreement to execute the Settlement, the State obtained in the Settlement the promise of Standard Offer wholesale suppliers (such as Constellation) to assume the responsibility for, and not to seek recovery of, Transition Period UCAP costs.

Citing well-established precedent such as United Man. Distributions Group v. FERC, 732 F.2d 202, 209 (D.C. Cir. 1984); FERC v. Triton Oil & Gas Corp., 712 F.2d 1450-1458-59 (D.C. Cir. 1983); Mobil Oil Corp. v. FPC, 417 U.S. 283, 312-13 (1974); New Orleans Pub. Serv., Inc. v. FERC, 659 F.2d 509, 511-12 (5th Cir. 1981); Pennsylvania Gas & Water Co. v. Fed. Power Comm’n, 463 F.2d 1242, 1246 (D.C. Cir. 1972), this Court has already ruled that the FERC Settlement “*has legal authority because it has become in effect a binding order of FERC.*” Opinion and Order at 18-19, n. 15 (emphasis added).

In the State's view, under principles of administrative claim preclusion, *e.g.*, University of Tennessee v. Elliott, 478 U.S. 788, 797-98 (1986); United States v. Utah Construction & Mining Co., 384 U.S. 394, 422 (1966); Bath Iron Works Corp. v. Director of Workers' Compensation Programs, 125 F.3d 18, 22-23 (1st Cir. 1997); Vilanova v. United States, 851 F.2d 1, 6 (1st Cir. 1988); waiver, *e.g.*, Exxon Corp. v. Federal Energy Regulatory Comm'n, 114 F.3d 1252, 1260 (D.C. Cir. 1997); and estoppel, Schiavulli v. School Committee of the Town of North Providence, 334 A.2d 416, 419 (R.I. 1975) (equitable estoppel), Patriot Cinemas, Inc. v. General Cinemas Corp., 834 F.2d 208, 214 (1st Cir. 1987) (judicial estoppel), the Settlement and Order are not subject to collateral attack and are *immediately, legally enforceable* against Constellation.

The State's claims seeking to enforce the Settlement and Order "involve the vindication of a public right of broad social importance." Montauk Oil, 859 F. Supp. at 679. The enforcement of Section VIII(A) of the Settlement and Order has statewide electric ratepayer impact of many millions of dollars, and is no different than the vindication by a sovereign of a pollution free waterway, *id.* 859 F. Supp. at 679, the pursuit of federal antitrust claims, Sam Reinfeld & Co., 530 F.2d at 681, or the vindication of federal anti-discrimination rights, Horne, 489 F. Supp. at 470. Like these other rights, public utility ratepayer interests, by their very nature, are interests "affected with the public interest." *E.g.*, Providence Gas Co. v. Burke, 475 A.2d 193, 196 (R.I. 1984). *See* G.L. § 39-1-1(a)(2)("[t]he business[ ] of distributing electrical energy . . . is affected with a public interest"); G.L. § 39-1-1(2)("[s]upervision and reasonable regulation by the state in which such businesses [public utilities] . . . carry on their

operations . . . are necessary to protect and promote the convenience, health, comfort, safety, accommodation and welfare of the people, and are a proper exercise of the police power of the state”).

Constellation has not presented compelling reasons to justify the imposition of a stay of the State’s Complaint pending the adjudication of its interlocutory appeal. The Court, therefore, should deny Constellation’s motion for stay pending appeal.

**3. A Stay Pending Appeal Will, In All Probability, Severely Prejudice Rhode Island Electric Ratepayers.**

While Constellation has failed to satisfy its heavy burden in this matter, the State and its electric ratepayers will, in all probability, be severely prejudiced if the Court does not proceed immediately to adjudicate their claims. Constellation, by its own estimate, seeks over \$150 million from Narragansett Electric and Rhode Island electric ratepayers for Transition Period (December 1, 2006 to May 30, 2010) UCAP costs. At the same time, Narragansett Electric’s wholesale standard offer supply contracts are set to expire on December 31, 2009. Under new contracts, Narragansett Electric may well experience a substantial increase in annual power supply costs, based on current market prices. By the Division’s calculation, this increase could total roughly \$100 million dollars based on the present market price of power. A \$100 million dollar increase in annual power supply costs increases a typical residential customer bill (500 kwhs) by about \$7.50 per month.

Were Constellation to somehow prevail against Narragansett Electric, the delay occasioned by its pending interlocutory appeal could necessitate payment on the resulting liability at or about the same time that the standard offer contracts expire. Rhode Island

electric ratepayers, then, would be subject to substantial “rate shock,” produced by the outcome of the instant matter in combination with the rate increases that will likely occur upon the expiration of the standard offer contracts. It is absolutely critical that the Court expeditiously address the merits of the State’s Complaint in order to give Rhode Island electric ratepayers certainty regarding their rates as soon as possible and to enable ratepayers to mitigate the probable “rate shock” in the unlikely event of an adverse decision. Just as importantly, expeditious adjudication of the State’s Complaint will assist regulators in maintaining their objective of providing rate stability in pricing decisions in the face of the probable scenario of higher market commodity costs after December 31, 2009.

**4. Constellation Will Not Be Prejudiced If A Stay Is Denied.**

Contrary to Constellation’s contention located on Pages 10 and 12 of its memorandum of law, the State’s claims are not “dependent” in any way whatsoever on the outcome of the Power Producer Agreements (“PPA”) litigation between Constellation and Narragansett Electric. Count I, II and III of the State’s Complaint seek declaratory and injunctive relief to enforce the Settlement and Order. The claims’ underpinnings rest on the theories of administrative claim preclusion, waiver and estoppel. Namely, the Settlement and Order serve as a legal and/or equitable bar to Constellation’s effort to recover Transition Period UCAP costs. The State’s claims relating to the enforcement of Section VIII(A), thus, arise out of Constellation’s conduct before FERC and the terms of the Settlement and Order, not the PPAs’ between Constellation and Narragansett

Electric.<sup>4</sup>

Since the State’s claims are non-arbitrable, e.g., Sierra Rutile, 937 F.2d at 750; Citrus Marketing Board, 843 F.2d at 225, and are not dependent in on the outcome of the PPA litigation, whatever the outcome in the First Circuit Court of Appeals, this Court will be required to address the merits of the State’s Complaint. Proceeding with the adjudication of the State’s claims forthwith, therefore, will not implicate a needless expenditure of “time, resources and costs” by Constellation, or, for that matter, by the Court. Constellation will not be prejudiced if its request for stay is denied.

Constellation’s reliance on Lummus Co. v. Commonwealth Oil Refining Co., 273 F.2d 613 (1<sup>st</sup> Cir. 1959) is misplaced. Lummus did not involve claims of an independent third party, which were not subject to arbitration. Nor in Lummus was one of the parties a sovereign, possessing claims the resolution of which would vindicate public rights of broad social importance.

In Lummus a single private party litigant alleged that a construction contract (which contained a standard arbitration provision) had been obtained by fraud or negligent misrepresentation. See Commonwealth Oil Refining Co. v. Lummus Co., 174 F. Supp. 485, 487 (D.P.R. 1959). Thus, when the matter reached First Circuit Court of Appeals on defendant-appellant’s motion to stay, “the entire dispute” (*i.e.*, all the claims

---

<sup>4</sup> From the outset, it has been abundantly clear that this proceeding consists of two components: (i) Narragansett Electric’s dispute with Constellation under four PPAs, and (ii) Narragansett Electric’s and the State’s claims against Constellation under the Settlement and Order, specifically Section VIII(A). In Component (i) only a single PPA contains a putatively applicable arbitration clause. The State’s claims against Constellation *are restricted* to enforcing the State’s rights under the Settlement and enforcing the Order, Component (ii), above. *None of the State’s (or Narragansett Electric’s claims in Component (ii)) are arbitrable.* Opinion and Order at 28.

By contending that a single putatively arbitrable PPA necessitates a stay of both components of this litigation, Constellation attempts to brush all aspects of the case before the Court with the veneer of arbitration. As discussed above, the vast weight of legal authority flatly contradicts Constellation’s efforts in this regard.

of all the parties) was likely subject to arbitration. Allowing discovery of these claims, the Court reasoned, would be “inimical” to the right of arbitration. Id. at 487.

That outcome is simply not the case here, where as previously discussed, none of the claims contained in the State’s Complaint are subject to arbitration, E.g., Sierra Rutile, 937 F.2d at 750; Citrus Marketing Board, 843 F.2d at 225; Montauk Oil, 859 F. Supp. at 679, or would or could be resolved by the results of the arbitration of a single PPA.<sup>5</sup>

Constellation’s reliance on Harvey v. Joyce, 199 F.3d 790 (5th Cir. 2000) and Subway Equipment Leasing Corp., 169 F.3d 324 (5th Cir. 1999) is also in error. In Harvey, the non-signatory to a contract containing an arbitration provision (CTC) requested a stay pending arbitration. Harvey, 199 F.3d at 795. In Subway Equipment Leasing, the signatory to a contract containing an arbitration provision sought to include affiliated non-signatories (SEL, SRI and SSS) within the scope of the stay pending arbitration. Subway Equipment Leasing, 169 F.3d at 329.

In both cases, it was non-signatories that *sought* arbitration. The Fifth Circuit Court of Appeals didn’t see the harm in staying the matters and allowing non-signatories to participate in the arbitration process. Forcing the signatory to try the case when the non-signatory also wanted arbitration would be “meaningless.” Harvey, 199 F.3d at

---

<sup>5</sup> Sevinor v. Merrill Lynch, Pierce, Fenner & Smith, 807 F.2d 16 (1st Cir. 1986) is inapposite to the case at bar as well. In Sevinor, the First Circuit Court of Appeals upheld the district court’s stay of a non-arbitrable RICO claim until an arbitration of an arbitrable 10b-5 claim had transpired. The same plaintiff and defendant were on opposite sides of both claims, and a 10b-5 violation was a predicate violation to success on the non-arbitrable, RICO claim. Id. at 18, 20. By contrast, in the case at bar, the State is not a party to the PPAs, and will not be a participant in the unlikely event of any arbitration between Narragansett Electric and Constellation. The outcome of any unlikely arbitration cannot bind the State or be accorded any evidentiary weight in the proceeding before this Court. E.g., American Renaissance Lines, Inc. v. Saxis Steamship Co., 502 F.2d 674, 677 (2d Cir. 1974) (“arbitrators do not have the power to bind a corporation which is not a party to the arbitration proceeding”). See International Broth. Of Elec. Workers, Local No. 265 v. OK Electric Co., 793 F.2d 214, 216 (8th Cir. 1986) (court properly refused request to enforce arbitration award against a non-party).

796.<sup>6</sup> See also Subway Equipment Leasing, 160 F.3d at 329 (although non-signatory affiliates had no right of arbitration, like DAI, they too desired arbitration and should be covered by the stay).

By contrast here, the State is not a signatory to any of the PPAs, and unlike CTC, SEL, SRI and SSS in the aforementioned cases, expressly refuses to arbitrate any of the claims contained in its Complaint, reserving instead to have its claims decided by the court of law. In these circumstances, the federal courts hold that a non-signatory to an arbitration provision, which seeks to have its claims addressed by a court, cannot be compelled to arbitrate. E.g., Citrus Marketing Board, 843 F.2d at 225; Montauk Oil, 859 F. Supp. at 679.

Constellation will not be prejudiced if the Court denies the company's motion for stay pending appeal and proceeds to adjudicate the merits of the State's Complaint as soon as possible. Nor will expeditious adjudication of the Complaint waste scarce judicial resources. The Court will have to address the merits of the Complaint, regardless of the outcome of Constellation's interlocutory appeal.

**B. CONSTELLATION'S NOTICE OF INTERLOCUTORY APPEAL DOES NOT DIVEST THIS COURT OF JURISDICTION TO ADJUDICATE THE STATE'S COMPLAINT.**

Constellation also attempts to contend that the mere filing of its notice of interlocutory appeal divests this Court of jurisdiction over the State's Complaint. The vast weight of authority holds otherwise. The United States Supreme Court has held, as Constellation concedes, that the filing of the notice of appeal only "divests the district

---

<sup>6</sup> The same reasoning—inapplicable to the case at bar—governed the outcome of Spencer Furniture, Inc. v. Media Arts Group, Inc., 349 F. Supp.2d 49 (D. Mass. 2003) cited by Constellation at Page 11 of its memorandum of law. In that case, the district court held that a non-signatory (*who desired arbitration*) was entitled the benefit of the stay provisions of the FAA. Id. at 53.

court of its control *over those aspects of the case involved in the appeal.*” Griggs v. Provident Consumer Discount Co., 459 U.S. 56, 58 (1982) (emphasis added). The United States Supreme Court has emphasized the limitations of this principle, explaining that the principle does “not imply that an appeal from a judgment of criminal contempt based on noncompliance with a discovery order transfers jurisdiction over the entire case to the court of appeal.” Marrese v. American Academy of Orthopaedic Surgeons, 470 U.S. 373, 379 (1985). Thus, even though a notice of appeal had been filed, the district court was not barred from amending and certifying for appeal a denial of a motion to dismiss. Id. at 378-79.

In cases that resemble the case at bar, the Eleventh, Ninth, Fifth, and Second Circuit Courts of Appeal have followed the United States Supreme Court’s observations regarding the scope of applicability of the divestiture rule in an interlocutory appeal setting regarding unrelated claims or matters that were contained in the appeal. In Alice L. v. Dusek, 492 F.3d 563 (5th Cir. 2007), the Fifth Circuit Court of Appeals expressly observed that the Griggs Court limited its divestiture holding to “*those aspects of the case involved in the appeal.*” Dusek, 492 F.3d at 565 (emphasis in the original). It followed, the Court reasoned, that “where an appeal is allowed from an interlocutory order, the district court may still proceed with matters not involved in the appeal.” Id. Accordingly, the Court of Appeals held that the district court possessed jurisdiction to compel discovery requests that were unrelated to the case on interlocutory appeal. Id. See also Britton v. Co-op Banking Group, 916 F.2d 1405, 1411 (9th Cir 1990) (district court possessed jurisdiction, after notice of interlocutory appeal from denial of arbitration request was filed, to enter default judgment as a discovery sanction); Pharmaceutical

Care Management Assoc. v. Maine Attorney General, 332 F. Supp.2d 258, 260 (D. Me. 2004) (interlocutory appeal of preliminary injunction does not deprive court of jurisdiction to proceed with discovery, pretrial preparation, motion practice and trial).

The Eleventh Circuit Court of Appeals has also adopted this reasoning. In Green Leaf Nursery v. E.I. Dupont de Nemours and Co., 341 F.3d 1292 (11th Cir. 2003), the Court of Appeals observed that “an interlocutory appeal does not completely divest the district court of jurisdiction . . . The district court has authority to proceed forward with portions of the case not related to the claims on appeal.” Id. at 1309. Thus, as the plaintiff’s RICO and spoliation claims were unrelated to the subject matter of the plaintiff’s interlocutory appeal, it was entirely appropriate for the district court to rule on the defendant’s Rule 12(c) motion directed at the plaintiff’s RICO and spoliation claims even though a notice of appeal had already been filed. Id. See also In Re: Salomon Inc. Shareholders’ Derivative Litigation, 68 F.3d 554, 556-57 (2d Cir. 1995) (district court properly declined to appoint arbitrator when party was not subject to arbitration provision) and Motorola Credit Corp. v. Uzan, 388 F.3d 39, 53-54 (2d Cir. 2004) (following the logic of In Re: Salomon that district court was not divested of jurisdiction over nonsignatories).

Any matters that are the subject of Constellation’s putative appeal relative to the alleged arbitration provision of a single PPA are completely unrelated to the claims contained in the State’s Complaint, which relate to the enforcement of Section VIII(A) of the Settlement and Order. As discussed above, the claims contained in the State’s Complaint are not, and cannot be, subject to arbitration since the State is not a party to the PPAs. E.g., Citrus Marketing Board, 843 F.2d at 225; Montauk Oil, 859 F. Supp. at

679. The State expressly refuses to arbitrate any of the claims contained in the Complaint. The State cannot be bound in the unlikely event of any arbitration that transpires between Narragansett Electric and Constellation on a single PPA. E.g., American Renaissance Lines, 502 F.2d at 677. This Court, then, “has authority to proceed” with the adjudication of the State’s Complaint forthwith, as the State’s Complaint is “not involved” in the appeal.<sup>7</sup> E.g., Dusek, 492 F.3d at 565; Green Leaf Nursery, 341 F.2d at 1309. Constellation’s efforts to suggest the absence of jurisdiction and/or to stay the district court adjudication of the State’s Complaint pending resolution of its appeal are without merit.<sup>8</sup>

---

<sup>7</sup> The principal cases cited by Constellation on Page 5 of its Memorandum of Law are inapposite to the case at bar relative to the State’s Complaint. In Bradford-Scott Data Corp. v. Physician Computer Network, Inc., 128 F.3d 504, 505 (7th Cir. 1997), for example, the plaintiff Bradford Scott (unlike the State here), failed to argue that its claims against the defendants were clearly non-arbitrable. In the Court’s words, it “was unnecessary to decide whether the district court could proceed on such a claim even when the appeal confined to a different claim is non-frivolous.” Id. at 506. McCauley v. Halliburton Energy Services, Inc., 413 F.3d 1158, 1162 (10th Cir. 2005) (the same holding, *i.e.*, the plaintiff “failed to argue before the district court that Halliburton’s § 16(a) appeal was frivolous”); Ehleiter v. Grapetree Shores, Inc., 482 F.3d 207, 214-225 (3rd Cir. 2007) (court affirmed *denial of stay* because owner had waived right to arbitrate). Compare Blinco v. Green Tree Servicing, Inc., LLC, 366 F.3d 1249, 1251 (11th Cir. 2004) (stay pending appeal was appropriate where *all claims between the same parties* might be governed by arbitration provision) with Green Leaf Nursery, 341 F.2d at 1309 (where the district court could proceed to adjudicate claims that were unrelated to the merits of the interlocutory appeal).

<sup>8</sup> For the same reasons, Constellation’s appeal vis-à-vis the State’s Complaint is frivolous.

**II. CONCLUSION**

For all of the foregoing reasons, the State respectfully requests the Court to deny Constellation's motion for stay pending appeal, and enter such other relief as the Court deems just and proper to effectuate the adjudication of the State's Complaint forthwith.

Respectfully submitted,

STATE OF RHODE ISLAND AND  
PROVIDENCE PLANTATIONS,  
and the RHODE ISLAND DIVISION OF  
PUBLIC UTILITIES AND CARRIERS  
By their attorney,

PATRICK C. LYNCH  
ATTORNEY GENERAL

/s/ Leo J. Wold

/s/ Richard B. Woolley

---

Leo J. Wold, # 3613

Richard B. Woolley, # 1452

150 South Main Street

Providence, RI 02903

Tel: 401-274-4400, ext. 2218

Fax: 401-222-3016

LWold@riag.ri.gov

RWoolley@riag.ri.gov

Dated: January 28, 2008

**CERTIFICATION**

I certify that on January 28, 2008, a copy of the within memorandum of law was filed electronically and served by mail on anyone unable to accept electronic filing. Notice of this filing will be sent by e-mail to all parties by operation of the Court's electronic filing as indicated on the Notice of Electronic Filing. Parties may access this filing through the Court's CM/ECF System.

/s/ Leo J. Wold

/s/ Richard B. Woolley

---

Leo J. Wold, # 3613

Richard B. Woolley, # 1452

150 South Main Street

Providence, RI 02903

Tel: 401-274-4400, ext. 2218

Fax: 401-222-3016

LWold@riag.ri.gov

RWoolley@riag.ri.gov

**TABLE OF CONTENTS**

	PAGE
<u>TABLE OF AUTHORITIES</u> .....	iii
<u>STATEMENT OF THE ISSUES</u> .....	1
<u>STATEMENT OF THE CASE</u> .....	1
<u>STANDARD OF REVIEW</u> .....	6
<u>STATEMENT OF FACTS</u> .....	7
<u>SUMMARY OF ARGUMENT</u> .....	10
<u>ARGUMENT</u> .....	11
I. <u>CONSTELLATION SEEKS A STAY PENDING ARBITRATION OF THE CLAIMS CONTAINED IN THE STATE’S COMPLAINT FOR THE FIRST TIME ON APPEAL</u> .....	11
A. <u>Constellation Never Requested The District Court To Stay The State’s Claims Pending Arbitration Once The District Court Permitted The State To Intervene And Join A Claim In The Proceeding Below</u> .....	11
B. <u>Constellation Never Requested The District Court To Stay The State’s Proposed Claims Pending Arbitration Prior To The District Court’s Permitting The State To Formally Intervene In The Proceeding Below</u> .....	16
II.    CONSTELLATION’S APPEAL IS NOT RIPE FOR REVIEW .....	21
III.   ASSUMING THE DISTRICT COURT ADDRESSED THE ISSUE OF WHETHER TO STAY THE STATE’S CLAIMS PENDING ARBITRATION (WHICH IT DID NOT), THE COURT DID NOT ABUSE ITS DISCRETION IN POST-PONING A FINAL DECISION ON THE ISSUE .....	26

A. A Stay Of Non-Arbitrable Claims Is Not Mandatory..... 26

B. The District Court Acted Well-Within Its Discretion ..... 27

CONCLUSION ..... 30

CERTIFICATE OF COMPLIANCE ..... 31

CERTIFICATE OF SERVICE ..... 32

## TABLE OF AUTHORITIES

<b>CASES</b>	<b>PAGE(S)</b>
<u>Am. Renaissance Lines, Inc. v. Saxis S.S. Co.</u> , 502 F.2d 674 (2d Cir. 1974).....	13, 14, 24, 28
<u>Bank One, Texas v. Montle</u> , 964 F.2d 48 (1st Cir. 1992).....	29
<u>Bath Iron Works Corp. v. Dir. of Workers’ Comp. Programs</u> , 125 F.3d 18 (1st Cir. 1997).....	22
<u>Berkovitz v. Home Box Office, Inc.</u> , 89 F.3d 24 (1st Cir. 1996) .....	29
<u>Bombardier Corp. v. Nat’l R.R. Passenger Corp.</u> , 333 F.3d 250 (D.C. Cir. 2003).....	12
<u>Bonilla v. Nazario</u> , 843 F.2d 34 (1st Cir. 1988).....	29
<u>City of Fall River, Mass. v. FERC</u> , 507 F.3d 1 (1st Cir. 2007) .....	21, 23, 24
<u>Clauson v. Smith</u> , 823 F.2d 660 (1st Cir. 1987) .....	13, 20
<u>Davis v. Lucent Tech. Inc.</u> , 251 F.3d 227 (1st Cir. 2001) .....	20
<u>Empresas Noroeste, Inc. v. Banco Central Corp.</u> , 806 F.2d 315 (1st Cir. 1986).....	14
<u>Exxon Corp. v. Fed. Energy Regulatory Comm’n</u> , 114 F.3d 1252 (D.C. Cir. 1997).....	22
<u>FERC v. Triton Oil &amp; Gas Corp.</u> , 712 F.2d 1450 (D.C. Cir. 1983) .....	22
<u>Fit Tech, Inc. v. Bally Total Fitness Holding Corp.</u> , 374 F.3d 1 (1st Cir. 2004).....	12
<u>Giannetta v. Boucher</u> , 981 F.2d 1245 (1st Cir. 1988).....	29
<u>In Re: Cont’l Inv. Corp.</u> , 637 F.2d 1 (1st Cir. 1980) .....	14

<u>Int’l Broth. of Elec. Workers, Local No. 265 v. OK Elec. Co.,</u> 793 F.2d 214 (8th Cir. 1986) .....	14, 24
<u>Johnston v. Holiday Inns, Inc.,</u> 595 F.2d 890 (1st Cir. 1979).....	14
<u>Klay v. All Defendants,</u> 389 F.3d 1191 (11th Cir. 2004) .....	7
<u>Leyva v. On the Beach, Inc.,</u> 171 F.3d 717 (1st Cir. 1999).....	29
<u>McCarthy v. Azure,</u> 22 F.3d 351 (1st Cir. 1994).....	23, 26, 28
<u>McCoy v. Mass. Inst. of Tech.,</u> 950 F.2d 13 (1st Cir. 1991) .....	20, 21
<u>Mobil Oil Corp. v. FPC,</u> 417 U.S. 283 (1974).....	22
<u>Moses H. Cone v. Mercury Const. Corp.,</u> 460 U.S. 1 (1983).....	26
<u>Muniz v. Rovira,</u> 373 F.3d 1 (1st Cir. 2004).....	13
<u>New Orleans Pub. Serv., Inc. v. FERC,</u> 659 F.2d 509 (5th Cir. 1981).....	22
<u>Nieves-Marquez v. Puerto Rico,</u> 353 F.3d 108 (1st Cir. 2003) .....	13
<u>Pennsylvania Gas &amp; Water Co. v. Fed. Power Comm’n,</u> 463 F.2d 1242 (D.C. Cir. 1972).....	22
<u>Patriot Cinemas, Inc. v. Gen. Cinemas Corp.,</u> 834 F.2d 208 (1st Cir. 1987).....	23
<u>Rogue-Rodriguez v. Lema Moya,</u> 926 F.2d 103 (1st Cir. 1991).....	13
<u>Schiavulli v. Sch. Comm. Of the Town of North Providence,</u> 334 A.2d 416 (R.I. 1975).....	22
<u>Semiconductor Energy Lab. Co., LTD v. Samsung Elec. Am., Inc.,</u> 116 F.3d 1497 (Fed. Cir. 1997) .....	7
<u>Sierra Fria Corp. v. Donald J. Evans, P.C.,</u> 127 F.3d 175 (1st Cir. 1997).....	6

Sierra Rutile Ltd. V. Katz, 937 F.2d 743 (2d Cir. 1991) ..... 26

Stella v. Town of Tewksbury, Mass., 4 F.3d 53 (1st Cir. 1993)..... 29

Talbott Big Foot, Inc. v. Boudreaux, 887 F.2d 611 (5th Cir. 1989) ..... 27

Teamsters, Chauffeurs, Warehousemen and Helpers Union, Local 59  
v. Superline Transp. Co., Inc., 953 F.2d 17 (1st Cir. 1992) ..... 20

Texas v. United States, 523 U.S. 296 (1998)..... 21, 23

United Man. Distribs. Group v. FERC, 732 F.2d 202 (D.C. Cir. 1984)..... 22

United States v. Utah Constr. & Mining Co., 384 U.S. 394 (1966) ..... 22

Univ. of Tenn. v. Elliott, 478 U.S. 788 (1986) ..... 22

Vilanova v. United States, 851 F.2d 1 (1st Cir. 1988)..... 22

Villafane-Neriz v. Fed. Deposit Ins. Corp.,  
 75 F.3d 727 (1st Cir. 1996)..... 20

Whyte v. Conn. Mutual Life Ins. Co., 818 F.2d 1005 (1st Cir. 1987)..... 14

**FEDERAL STATUTES**

9 U.S.C. § 3 ..... 10, 13, 26

9 U.S.C. § 4 ..... 13

9 U.S.C. § 16(a)(1)(A) ..... 13

**ADMINISTRATIVE DECISIONS**

Constellation Energy Commodities Group, Inc.,  
119 FERC ¶ 61,292 (2007) ..... 4

Constellation Energy Commodities Group, Inc.,  
122 FERC ¶ 61,025 (2008) ..... 5

Devon Power LLC, et al., 115 FERC ¶ 61,340 (2006) ..... 1

**MISCELLANEOUS**

5B C. Wright & A. Miller, Federal Practice & Procedure § 1357 (2004).... 29

### **STATEMENT OF ISSUES**

Whether Constellation seeks a stay pending arbitration of the claims contained in the State's Complaint, for the first time on appeal.

Whether Constellation's appeal is ripe for review.

Assuming the district court addressed the issue of whether or not to stay the State's claims, pending arbitration (which in fact it did not), whether the court abused its discretion in postponing a final decision on the issue.

### **STATEMENT OF THE CASE**

On August 1, 2006, Constellation Commodities Group, Inc. ("Constellation") wrote to The Narragansett Electric Company ("Narragansett") seeking negotiation of appropriate, additional compensation under certain Power Purchase Agreements ("PPAs") to which the companies are signatories (A-531). On September 11, 2006, Narragansett filed a complaint (A-10-21) with the court below against Constellation seeking, among other relief, a declaratory judgment that Constellation is barred from seeking Transition Period unforced or installed capacity ("UCAP") costs from Narragansett under a settlement agreement (the "Settlement") (A-272-372) approved by the Federal Energy Regulatory Commission ("FERC") in an Order of the agency (the "Order") in Devon Power LLC, et al., Docket Nos. ER03-563-030 & ER03-563-055, 115 FERC ¶ 61,340 (A-446-529).

On October 23, 2006, Constellation filed a Motion to Dismiss or in the Alternative to Compel Arbitration and Stay Proceedings and memorandum (“Motion to Dismiss”) (A-23-61). On December 13, 2006, Narragansett filed an objection and memorandum to the Motion to Dismiss (A-532-55).

On January 9, 2007, the Rhode Island Division of Public Utilities and Carriers (“Division”) and the State of Rhode Island and Providence Plantations (collectively referred to herein as the “State”) filed a Motion to Intervene and to Join Claim and supporting memorandum (“Motion to Intervene”) in the proceeding (A-578-603). On January 18, 2007, the district court ordered Constellation to file a response to the Motion to Intervene by January 26, 2007, as well as to file a motion to dismiss the additional claim contained in the State’s proposed complaint by January 29, 2007 (A-604).

Pursuant to the schedule established by the court, Constellation filed its respective paperwork opposing the Motion to Intervene (A-605-23) and responding to the State’s additional claim (A-624-45). Nowhere in its paperwork did Constellation request the district court to stay the State’s proposed claims pending arbitration in the event the court permitted the State to intervene in the proceeding.

On February 7, 2007, the district court held a hearing on the State’s Motion to Intervene (A-665-720). On February 14, 2007, the district court

deferred ruling on the Motion to Intervene until the court had decided Constellation's Motion to Dismiss Narragansett's complaint (A-785-86).

On March 1, 2007, Constellation filed a Petition for Declaratory Order (the "Petition") with FERC seeking a declaratory ruling that the Settlement and Order did not interfere with the company's alleged contractual rights under the PPAs (A-833-55).

On March 2, 2007, Constellation informed the district court of the filing of the Petition (A-857). On March 5, 2007, the district court heard Constellation's Motion to Dismiss (A-871-955). At the hearing, Constellation alleged that two of the PPAs contained mandatory arbitration provisions that required Narragansett and Constellation to arbitrate Constellation's demand of an "equitable adjustment" resulting from Transition Period UCAP costs under those PPAs. (A-899, 940). At no time did Constellation request the district court to stay the State's claims pending arbitration should the court permit the State to intervene in the proceeding.

Pursuant to the district court's directive at the March 5, 2007 hearing, on March 12, 2007, Constellation formally filed a Motion to Stay the proceedings pending a decision by FERC of the Petition (Docket Entry No. 35). The State and Narragansett objected to the Motion to Stay on March 22, 2007 and March

26, 2007, respectively (Docket Entry No. 37). Constellation filed a reply on April 4, 2007 (Docket Entry No. 38).

On April 10, 2007, the district court directed Constellation to provide the court with a copy of FERC's decision on the Petition as soon as reasonably possible, indicating the decision would be helpful in deciding the pending motions (A-957-58).

On June 21, 2007, FERC issued an order denying the Petition. In Re: Constellation Energy Commodities Group, Inc., 119 FERC ¶ 61,292 (2007) Constellation requested a rehearing on July 23, 2007.

On December 11, 2007, the district court issued its Opinion and Order (the "Opinion") resolving Constellation's Motion to Dismiss Narragansett's complaint and the State's Motion to Intervene (A-959-88).

Pursuant to the Opinion, the State filed and served its complaint against Constellation on December 12, 2007 (A-989-99). In the complaint, the State seeks to enforce the Settlement by requesting declaratory and injunctive relief against Constellation. In essence, the State alleges that Constellation is barred by the Settlement and Order (Counts I and II) from seeking to recover Transition Period UCAP costs from Narragansett Electric and Rhode Island electric ratepayers. The State further alleges that Constellation's conduct vis-à-vis the State precludes recovery of these costs as well (Count III).

On January 9, 2008, Constellation filed a Notice of Appeal in the court below seeking to review aspects of the Opinion (A-1000-02). On the same date, Constellation also filed a Suggestion of the Absence of Jurisdiction and/or Motion to Stay Pending Appeal and supporting memorandum (“Suggestion”) (A-1003-19).

On January 15, 2008, Constellation filed its answer to the State’s complaint (Docket Entry No. 53) and answer and counterclaims to Narragansett’s complaint (A-1020-49).

On January 18, 2008, FERC denied a request by Constellation to rehear the Petition. Constellation Energy Commodities Group, Inc., 122 FERC ¶ 61,025 (2008).

The State and Narragansett objected to the Suggestion on January 28, 2008 (A-1050-66) and February 11, 2008 (A-1067-80), respectively. Narragansett answered Constellation’s counterclaim on February 18, 2008 (A-1081-93). Constellation filed its reply on February 18, 2008 (A-1094-1108).

On February 12, 2008, Constellation filed a statement of issues in this Court claiming that the district court erred when it allegedly denied Constellation’s motion to compel arbitration of two PPAs and when allegedly it denied Constellation’s motion to stay “all proceedings” pending arbitration.

Constellation reasserts these claims of error in its Brief (Constellation's Brief at 3, 41).

On February 15, 2008, the court below noticed the Suggestion for hearing for March 5, 2008. The hearing was continued to April 30, 2008. As of the date of this Brief, the court has neither heard nor ruled on the Suggestion.

### **STANDARD OF REVIEW**

The first issue raised by the State requires an assessment of the record to determine whether Constellation actually requested the court below to stay the State's claims pending arbitration. As resolution of this issue is "more law-dominated" rather than representing a "fact-intensive exercise," *de novo* review obtains. Sierra Fria Corp. v. Donald J. Evans, P.C., 127 F.3d 175, 181 (1st Cir. 1997) (providing a cogent framework to litigants for determining the standard of review).

The second issue raised by the State requires the Court to determine whether the adjudication of the State's claims will moot Constellation's appeal in its entirety. Resolution of this issue is also predominantly "law-dominated;" therefore, *de novo* review obtains to this issue as well. Id.

Assuming the court below addressed the issue (which it did not), review of a ruling postponing final adjudication of whether or not to stay the State's nonarbitrable claims under the Federal Arbitration Act is reviewable under an

abuse of discretion standard. Klay v. All Defendants, 389 F.3d 1191, 1203 (11th Cir. 2004); Semiconductor Energy Laboratory Co., Ltd. v. Samsung Elec. Am., Inc., 116 F.3d 1497, \*5 (Fed. Cir. 1997) (unpublished disposition).

### **STATEMENT OF FACTS**

In 2004, the Independent System Operator for New England (“ISO New England”) proposed a locational installed capacity (“LICAP”) market. Under this market, ISO New England proposed to allocate capacity payments to electricity generators by geographic zones (*i.e.*, by location) based on certain formulas that were designed to provide an incentive for the creation of generation capacity. State regulatory bodies, public utilities, municipal load serving entities and many others objected to the LICAP market for, among other reasons, it was estimated that imposition of a market would cost New England electric ratepayers many hundreds of millions of dollars without providing adequate capacity or reliability. As a consequence of this vehement opposition, FERC postponed the implementation of the LICAP market in the proceeding then pending before FERC, giving the parties an additional opportunity to pursue a settlement.

In or about the Fall of 2005 and into early 2006, regulatory and consumer representatives of the six New England States, generators, transmission owners, and power suppliers, among others, negotiated the Settlement that proposed the

adoption of a Forward Capacity Market (“FCM”), as an alternative to the LICAP market (A-272-372). The Settlement was the end product of a series of over 30 formal settlement conferences and negotiations, involving 115 parties, taking place over about a four-month period with the active participation and involvement of Administrative Law Judge Lawrence Brenner (A-782).

The State, through its agent the Division, intervened in the proceeding before FERC, and participated in the settlement negotiations and conferences. Narragansett and Constellation also participated in these conferences and negotiations (A-992).

During the course of the settlement proceedings, the State became a “swing” settlement participant (A-992). Without the State’s agreement to become a Settling Party, ISO-New England would not recommend the FCM to FERC, and FERC would not approve the FCM. Further, without the State’s agreement to become a settling party, the FCM would not have been created in New England, and Rhode Island standard offer wholesale suppliers (of which Constellation is one), among others, would have faced or incurred continued vigorous opposition to the proposed LICAP market, endless litigation and substantial monetary detriment (A-993).

In consideration of the State’s agreement to become a settling party, settlement participants, including Rhode Island standard offer wholesale

suppliers such as Constellation, included language in the proposed Settlement whereby they agreed they would not seek recovery of Transition Period UCAP costs (A-993). Section VIII(A) of the Settlement provides as follows:

The current UCAP products shall be retained for the period commencing on December 1, 2006 and ending on May 30, 2010 (the "Transition Period") as provided for in Part VIII.I. Payments will be made to UCAP entitlement holders, and made by UCAP obligation holders including wholesale standard offer suppliers in Rhode Island as under the current Market Rules and tariffs; it being understood that the agreement of wholesale standard offer suppliers in Rhode Island to make UCAP payments is contingent upon the agreement of the state of Rhode Island utility regulatory authorities to support the settlement (A-323).

On January 31, 2006, Constellation orally represented to Judge Brenner and to the State, among others, that the company would oppose the FCM contained in the Settlement (A-768). Constellation was to report back to the Judge, Narragansett and the State if the company had any opposition to Section VIII(A) of the Settlement (A-776).

Constellation did not report back to the State and Narragansett (and on information and belief, did not report back to Judge Brenner) that it had any opposition to Section VIII(A) of the Settlement (A-727). Constellation further did not file any comments or objection regarding the Settlement as required by FERC rules, and instead simply chose not to sign the Settlement (A-994). The

State and Narragansett, among many other settlement participants, were signatories to the Settlement (A-358, 364).

On April 11, 2006, Judge Brenner reported to FERC that while Constellation initially indicated at the time that the company would oppose the Settlement (A-768), Constellation in the end did not oppose it (A-776).

By the Order dated June 16, 2006, FERC (via the Order) approved the Settlement, accepting the agreement as “a just and reasonable outcome of this proceeding consistent with the public interest” (A-446). Constellation did not oppose, appeal or seek a rehearing of the Order (A-994).

### **SUMMARY OF ARGUMENT**

Constellation claims that the district court erred in refusing to stay the State’s claims pending arbitration under 9 U.S.C § 3. The State did not become an intervenor in the proceeding below until the district court ruled on Constellation’s Motion to Dismiss Narragansett’s complaint. Neither before nor after the State became an intervenor and joined an additional claim did Constellation request the district court to stay the State’s proposed or filed claims pending arbitration. Constellation raises its claim—that the district court erred in refusing to stay the State’s claims pending arbitration—for the first time on appeal. The claim is barred by the “raise-or-waive” rule, and does not fall within any exception to the rule.

The district court has ruled that Constellation is bound by the Settlement and Order, which contains a provision that the State contends bars Constellation from recovering Transition Period UCAP costs. Resolution of the State's claims in favor of the State will moot Constellation's appeal in its entirety. Constellation's appeal rests upon a contingent future event—defeat of the State's claims—that may not occur as anticipated or indeed may not occur at all. The appeal is not ripe for review.

Even if the court below addressed the issue of whether or not to stay the State's claims pending arbitration (which the State contends the court did not), the court did not abuse its discretion in postponing a final decision on the merits of this issue.

### ARGUMENT

#### **I. CONSTELLATION SEEKS A STAY PENDING ARBITRATION OF THE CLAIMS CONTAINED IN THE STATE'S COMPLAINT FOR THE FIRST TIME ON APPEAL.**

##### **A. Constellation Never Requested The District Court To Stay The State's Claims Pending Arbitration Once The District Court Permitted The State To Intervene And Join A Claim In The Proceeding Below.**

The Opinion of the court below resolved the following two of three pending motions: (i) it denied Constellation's Motion to Dismiss Narragansett's complaint, and (ii) it granted the State's Motion to Intervene (A-988). With respect to the third pending matter, Constellation's motion to dismiss the State's

proposed complaint, the court decided that while the motion “ha[d] been fully briefed by Constellation and the State,” it “is axiomatic that an intervenor does not become a party to an action until intervention is actually granted. [citation omitted]” (A-988). The court proceeded to state that “now that the [c]ourt has granted the State’s Motion to Intervene and to Join Claim,” the court would require the State to “formally file its complaint against Constellation” (A-988). How Constellation proceeded against that pleading once it was filed was left to “Constellation’s discretion,” although the court was “disinclined” to dismiss the complaint for “lack of standing” (A-988).

Pursuant to the Opinion, the State filed its complaint against Constellation with the district court on December 12, 2007 (A-989-99). The complaint was served on Constellation through the ECF system the same day. Constellation filed its Notice of Appeal on January 9, 2008. At no time between December 11, 2007 and January 9, 2008 did Constellation file a motion with the court below to stay the State’s claims pending arbitration. The record is devoid of any such request.<sup>1</sup>

---

<sup>1</sup> Constellation’s failure to request the court below to stay the State’s action, pending arbitration raises another issue for the Court. Outright motions to dismiss are not treated as motions to stay pending arbitration, and therefore, do not trigger appellate jurisdiction under 9 U.S.C. § 3. Bombardier Corp. v. Nat’l R.R. Passenger Corp., 333 F.3d 250, 254 (D.C. Cir. 2003). Similarly, a request for dismissal will trigger the Court’s appellate jurisdiction under 9 U.S.C. § 3 only when it is made in favor of a “*clear*” invocation of an accountant dispute

By contending on appeal that the court below erred in denying a motion to stay pending arbitration “all proceedings” (which Constellation contends encompasses the State’s claims (Constellation’s Brief at 3, 41)), Constellation presents a matter—the issue of whether the State’s claims should be subject to a stay pending arbitration—for the first time on appeal. This Constellation may not do. Muniz v. Rovira, 373 F.3d 1, 4 (1st Cir. 2004) (“legal theories not raised squarely in the lower court cannot be broached for the first time on

---

resolution remedy and no one has been prejudicially misled. Fit Tech, Inc. v. Bally Total Fitness Holding Corp., 374 F.3d 1, 6 (1st Cir. 2004) (emphasis added). In the proceedings below, Constellation failed to request the district court to stay the State’s action pending arbitration, and the State did not have any opportunity in the district court to counter the arguments set forth on Pages 44-48 of Constellation’s Brief. As applied to the State’s claims, Constellation’s second claim of error does not constitute “an appeal taken” from “an order refusing to stay any action under section 3 of this title.” 9 U.S.C. § 16(a)(1)(A).

Constellation’s second claim of error as applied to the State’s action also is not “pendent” to the same claim of error relating to Narragansett’s action. See Roque-Rodriguez v. Lema Moya, 926 F.2d 103, 105 (1st Cir. 1991) (“interlocutory review” of one issue in a case, “does not in and of itself confer jurisdiction over other contested issues in the case”). The State simply cannot be bound by any hypothetical arbitration that may transpire between Constellation and Narragansett. E.g., Am. Renaissance Lines, Inc. v. Saxis S.S. Co., 502 F.2d 674, 677 (2d Cir. 1974). Thus, whether the court below allegedly erred in refusing to stay the State’s claims pending arbitration is not “inextricably intertwined” with the asserted issue of whether the court erred in refusing to stay Narragansett’s similar, non-arbitrable claims. Compare In Re: Talbott Big Foot, Inc., 887 F.2d 611, 614 & n. 4 (5th Cir. 1989) (FAA has no application to require stay of lawsuit when arbitrator’s award cannot have preclusive effect upon party) with Nieves-Marquez v. Puerto Rico, 353 F.3d 108, 123 (1st Cir. 2003) (pendent damages issue is inextricably intertwined with the issue of Eleventh Amendment immunity).

appeal”); Clauson v. Smith, 823 F.2d 660, 666 (1st Cir. 1987) (an appellant is only permitted to raise an issue for the first time on appeal in “extraordinary circumstances”).

Nor does Constellation’s newfound theory fall within the narrow exception to the “raise-or-waive” rule. Whyte v. Conn. Mut. Life Ins. Co., 818 F.2d 1005, 1009 (1st Cir. 1987) (permitting an appellant to raise an issue for the first time on appeal in “horrendous cases where a gross miscarriage of justice would occur” and the new ground advanced is “so compelling as virtually to insure appellant’s success”); Johnston v. Holiday Inns, Inc., 595 F.2d 890, 894 (1st Cir. 1979) (the same).

The State is not a party to the PPAs. Its claims are not subject to arbitration and the State cannot be bound by the outcome of any arbitration between Constellation and Narragansett. E.g., Am. Renaissance Lines, 502 F.2d at 677 (“arbitrators do not have the power to bind a corporation which is not a party to the arbitration proceeding”). See Int’l. Broth. Of Elec. Workers, Local No. 265 v. OK Elec. Co., 793 F.2d 214, 216 (8th Cir. 1986) (court properly refused request to enforce arbitration award against a non-party). Success on appeal based on Constellation’s new theory—that the State’s non-arbitrable claims should be stayed pending arbitration—therefore, is highly improbable rather than “virtually insured.”

For the very same reasons, Constellation will hardly be subject to a “gross miscarriage of justice” should the company be required to immediately defend the State’s claims in the court below. Constellation seeks to avoid compliance with a binding settlement and order of FERC. Through its district court action, the State is attempting to obtain judicial intervention to enforce the Settlement and Order. Like any other defendant in litigation, Constellation simply does not enjoy the right to be free from cost, or the possibility of different outcomes associated with the State’s effort to enforce the binding Settlement and Order. Moreover, any additional costs that Constellation may incur in defending the State’s effort to resolve the company’s imminent lawsuit hardly constitutes a “gross miscarriage of justice.” In Re: Cont’l Inv. Corp., 637 F.2d 1, 6 (1st Cir. 1980) (“[o]ur decisions have consistently declined to allow the prospect of possibly substantial litigation burden, or even relitigation itself to circumvent the policy against piecemeal review”); Empresas Noroeste, Inc. v. Banco Central Corp., 806 F.2d 315 (1st Cir. 1986) (potential burdens of litigation or relitigation cannot alone constitute irreparable harm).

Constellation raises its claim—that the district court erred in refusing to stay the State’s claims pending arbitration—for the first time on appeal. The claim is barred by the “raise-or-waive” rule, and does not fall within any

exception to the rule. Constellation's second claim of error as applied to the State's claims, therefore, should be dismissed.

**B. Constellation Never Requested The District Court To Stay The State's Proposed Claims Pending Arbitration Prior To The District Court's Permitting The State To Formally Intervene In The Proceeding Below.**

At no time before the district court issued the Opinion did Constellation ever request the court to stay the State's proposed claims pending arbitration. A review of the travel of the case makes this assertion eminently clear.

The State did not seek leave to intervene and join claim in the proceeding below until January 9, 2007, over three months after Narragansett had filed its complaint and over two months after Constellation had sought to dismiss/stay that complaint (A-578). Constellation's request for stay pending arbitration, therefore, was directed exclusively at Narragansett's then pending non-arbitrable claims (*i.e.*, the "proceeding" or matter then directly before the district court).

On January 18, 2007, the district court ordered Constellation to file a response to the State's Motion to Intervene by January 26, 2007, as well as to file a motion to dismiss the additional count contained in the State's proposed complaint by January 29, 2007 (A-604).

Pursuant to the schedule established by the district court, Constellation filed its paperwork with the court opposing the Motion to Intervene (A-605-23), and, exercising extra “precaution,” (A-987) responded to the State’s additional claim by filing a motion to dismiss the State’s entire proposed complaint (A-624-45). Nowhere in Constellation’s opposition to the Motion to Intervene did Constellation request the court to stay the State’s proposed claims pending arbitration.<sup>2</sup> Similarly, in Constellation’s memorandum in support of its motion to dismiss the proposed complaint, Constellation sought outright dismissal of the State’s proposed claims based upon theories of “lack of subject matter jurisdiction, lack of standing, and failure to plead a claim upon which relief can be granted” (A-624). Nowhere did Constellation contend that the court below should stay the State’s claims pending arbitration in the event the State was made a party to the proceeding.

---

<sup>2</sup> Constellation contended that “intervention by the State is premature” because State intervention was an issue “...which arbitrators [were] well suited to answer . . . not the Court” (A-605-06). The entire thrust of Constellation’s argument to the court below was that the State should not be made a party to the proceeding for various reasons: intervention was premature, lack of standing, lack of cognizable interest, *etc.* (A-607-19), not that the State’s proposed non-arbitrable claims should be stayed pending any hypothetical arbitration that might transpire between Constellation and Narragansett Electric.

On February 7, 2007, the district court held a hearing on the State's Motion to Intervene.<sup>3</sup> On February 14, 2007, the district court deferred ruling on the Motion to Intervene until the court decided Constellation's Motion to Dismiss Narragansett's complaint (A-785-86).

On March 5, 2007, the district court heard Constellation's Motion to Dismiss. At the hearing, Constellation again asserted that two of the PPAs contained provisions that required Narragansett and Constellation to arbitrate issues relating to the Constellation's demand for "equitable adjustment" (A-899, 940). At no time did Constellation provide the court with a legal argument, theory or basis explaining why the State's non-arbitrable claims should be stayed pending arbitration when the State could neither be compelled to arbitrate nor bound by the results of any arbitration that might transpire between Constellation and Narragansett.<sup>4</sup>

---

<sup>3</sup> At the hearing, Constellation reiterated the arguments presented in its opposition papers (A-704, 710).

<sup>4</sup> The first time Constellation intimated to the court below that the State's claims should be stayed pending arbitration occurs in the seventeenth affirmative defense of Constellation's Answer that Constellation filed in response to the State's complaint on January 15, 2008 (Docket Entry 53, Page 7). Constellation has never requested the court below to rule on the propriety of this affirmative defense.

On January 9, 2008, Constellation filed the Suggestion in the court below, which included a request for stay "pending appeal" (A-1003). Constellation's "newfound" argument in this Court (Constellation's Brief 44-48) is taken

The Opinion reflects this conclusion. According to the court, Constellation “alternatively argue[d]” that “the [c]ourt should stay the proceedings pending arbitration pursuant to the dispute resolution provisions in the PPAs” (A-978). Over the next several pages of the Opinion, the district court analyzed the relevant provisions of the PPAs (A-980-83). The court proceeded to assess whether “a change[ ] ha[d] been effected in the rights and obligations assigned to “NEC” or “Constellation” and whether the court could “ascertain” as between “NEC’s argument” and “Constellation’s argument to the converse” whether “to arbitrate disputes like that presented here under any of the PPAs” (A-984).

The court’s analysis and rulings are limited in scope, restricted to deciding Constellation’s Motion to Dismiss Narragansett’s complaint. The court expressly chose not to address Constellation’s motion to dismiss the State’s proposed complaint, or, how the court would proceed once the State formally filed its complaint against Constellation (A-988). The court also

---

virtually verbatim from Constellation’s argument (made for the first time to the court below in the Suggestion) that these claims should be stayed “pending appeal” (A-1013-17). As of the date of the filing of this Brief, the district court has not heard Constellation’s request for stay pending appeal. (The request for stay is scheduled for hearing on April 30, 2008.) The near-identical nature of the two arguments and the timing of their appearance in the court below and in this Court respectively is further corroboration that Constellation’s second claim of error as applied to the State’s claims is raised for the first time on appeal.

expressly left it up to Constellation to decide how to proceed (including presumably seeking a stay pending arbitration of the State's claims) once the State had formally filed its complaint (A-988). The court, therefore, never considered the issue of whether or not it should stay the State's proposed claims pending arbitration, were the court to permit the State to intervene in the proceeding.

Constellation's claim in this forum that the district court erred in refusing to stay the State's claims pending arbitration surfaces for the first time on appeal. It is, therefore, precisely the type of "newfound theory" or "afterthought" which is barred by the "raise-or-waive" rule and does not come within the narrow exception to the rule. Davis v. Lucent Tech., Inc., 251 F.3d 227, 232 (1st Cir. 2001) ("newfound theories," which the appellee did not have an opportunity to oppose in the court below or which the Judge could not examine, do not fall within this exception to the "raise-or-waive" rule); Villafane-Neriz v. Fed. Deposit Ins. Corp., 75 F.3d 727, 734 (1st Cir. 1996) (court will not consider an argument presented for first time on appeal unless "gross miscarriage of justice" would occur); Clauson, 823 F.2d at 666 ("afterthought" legal theory cannot surface for first time on appeal). See also Teamsters, Chauffeurs, Warehousemen and Helpers Union, Local 59 v. Superline Transp. Co., Inc., 953 F.2d 17, 21 n. 5 (1st Cir. 1992) (it is not for the

court to “launch a search for usable needles in every haystack that dots the antecedent record, unassisted by the appellant who seeks the benefit from such a rummage”); McCoy v. Mass. Inst. Of Tech., 950 F.2d 13, 22 n. 7 (1st Cir. 1991) (it is up to the party “to incorporate all relevant arguments in the papers that directly address a pending motion”). Accordingly, Constellation’s second claim of error, as applied to the State’s claims, should be dismissed.

## **II. CONSTELLATION’S APPEAL IS NOT RIPE FOR REVIEW.**

The United States Supreme Court has held that “ripeness” requires an evaluation of both the “fitness of the issues for judicial decision and the hardship to the parties of withholding court consideration.” Texas v. United States, 523 U.S. 296, 301 (1998). Under the first prong of this ripeness inquiry, fitness for judicial review, this Court considers “whether the matter involves uncertain events which may not happen at all, and whether the issues involved are based on legal questions or factual ones.” City of Fall River, Mass. v. FERC, 507 F.3d 1, 6 (1st Cir. 2007). In this context, “premature review not only can involve judges in deciding issues not sufficiently concrete to allow for focus and intelligent analysis, but it also can involve them in deciding issues unnecessarily, wasting time and effort.” Id. In all events, “[a] claim is not ripe for adjudication if it rests upon “contingent future events that may not occur as

anticipated or indeed may not occur at all.” Texas, 523 U.S. at 300; City of Fall River, 507 F.3d at 6.

In its pending appeal, Constellation seeks a stay of the State’s claims pending arbitration of certain rights and obligations under two PPAs to which Constellation and Narragansett are signatories (Constellation’s Brief 3, 41). In the court below, the State contends that in the course of highly complex and lengthy proceedings before FERC, the State negotiated and obtained, for good and valid consideration, the promise of standard offer wholesale suppliers, such as Constellation, to forego the recovery of Transition Period UCAP costs. Constellation was a participant in the FERC proceeding and chose not to sign the Settlement but did not in the end oppose it (A-993). Administrative Law Judge Brenner reported Constellation’s non-opposition to the Settlement on April 11, 2006 (A-776). FERC approved the Settlement by Order dated June 16, 2006 (A-446).

Citing well-established precedent such as United Man. Distribs. Group v. FERC, 732 F.2d 202, 209 (D.C. Cir. 1984); FERC v. Triton Oil & Gas Corp., 712 F.2d 1450, 1458-59 (D.C. Cir. 1983); Mobil Oil Corp. v. FPC, 417 U.S. 283, 312-13 (1974); New Orleans Pub. Serv., Inc. v. FERC, 659 F.2d 509, 511-12 (5th Cir. 1981); Pennsylvania Gas & Water Co. v. Fed. Power Comm’n, 463 F.2d 1242, 1246 (D.C. Cir. 1972), the court below has ruled that the Settlement

“has legal authority because it has become in effect a binding order of FERC” (A-977-78).

In the State’s view, under principles of administrative claim preclusion, e.g., Univ. of Tenn. v. Elliott, 478 U.S. 788, 797-98 (1986); United States v. Utah Constr. & Mining Co., 384 U.S. 394, 422 (1966); Bath Iron Works Corp. v. Dir. of Workers’ Comp. Programs, 125 F.3d 18, 22-23 (1st Cir. 1997); Vilanova v. United States, 851 F.2d 1, 6 (1st Cir. 1988); waiver, e.g., Exxon Corp. v. FERC, 114 F.3d 1252, 1260 (D.C. Cir. 1997); and estoppel, Schiavulli v. Sch. Comm. of the Town of North Providence, 334 A.2d 416, 419 (R.I. 1975) (equitable estoppel), Patriot Cinemas, Inc. v. Gen. Cinemas Corp., 834 F.2d 208, 214 (1st Cir. 1987) (judicial estoppel), the Settlement and Order are not subject to collateral attack and are immediately, legally enforceable against Constellation.

Adjudication by the court below of the State’s claims in favor of the State will moot Constellation’s appeal in its entirety. If the court below holds that the Settlement and Order precludes Constellation from recovering Transition Period UCAP costs, then there will be nothing to arbitrate and there will be no need to consider whether or not to stay the State’s non-arbitrable claims pending arbitration. Constellation’s appeal, thus, rests upon a “contingent future event”—a favorable outcome to Constellation in the court below

regarding the merits of the State’s claims—that in all probability will “not occur at all.” E.g., Texas, 523 U.S. at 300; City of Fall River, 507 F.3d at 6. As such, the issues presented by Constellation’s appeal are not fit for judicial decision at this time.

The balance of hardship to the parties of withholding court consideration does not counsel otherwise. City of Fall River, 507 F.3d at 7. The State cannot be compelled to arbitrate its claims, McCarthy v. Azure, 22 F.3d 351, 355 (1st Cir. 1994), and cannot be bound by an arbitrator’s rulings in the unlikely event that arbitration proceedings transpire between Constellation and Narragansett. E.g., Am. Renaissance Lines, 502 F.2d at 677 (“arbitrators do not have the power to bind a corporation which is not a party to the arbitration proceeding”). See Int’l. Broth. of Elec. Workers, Local No. 265, 793 F.2d at 216 (court properly refused to enforce arbitration award against a non-party).

Constellation, therefore, will face the same litigation costs and the same risk of contrary rulings regardless of whether or not such a proceeding takes place. Just as importantly, Constellation retains every opportunity to challenge the district court’s rulings in this Court in the event the district court rules in favor of the State on the merits of its complaint. See City of Fall River, 507 F.3d at 7 (ability of appellant to challenge project upon FERC approval

mitigates appellant's hardship in "balance of hardship" analysis). Withholding the Court's consideration will impose no hardship at all on Constellation.

By contrast, the State may be prejudiced if the Court were to consider Constellation's premature appeal. Constellation is attempting to violate the binding Settlement and Order of FERC by seeking to recover Transition Period UCAP costs from Narragansett, and therefore, from Rhode Island electric ratepayers. The State is attempting to have Constellation's demand and imminent lawsuit resolved by the district below as expeditiously as possible. At the same time, Narragansett's wholesale standard offer supply contracts are set to expire on December 31, 2009. Under new contracts, Narragansett may well experience a substantial increase in annual power supply costs, based on current market prices.<sup>5</sup>

Should the State not prevail on the merits (which the State believes is unlikely), consideration of Constellation's premature appeal could necessitate payment on the resulting liability at or about the same time that the standard offer contracts expire. Rhode Island electric ratepayers would, then, be subject to substantial "rate shock," produced by the outcome of the instant matter in

---

<sup>5</sup> By the State's calculation, this increase could total roughly \$100 million dollars based on the present market price of power. A \$100 million dollar increase in annual power supply costs increases a typical residential customer bill (500 kWhs) by about \$7.50 per month.

combination with the rate increases that will likely occur upon the expiration of the standard offer contracts.

Withholding consideration of Constellation's appeal, however, will allow Rhode Island electric ratepayers certainty (at least from a favorable district court decision) regarding their rates as soon as possible and will enable ratepayers to mitigate the probable "rate shock" in the unlikely event of an adverse decision. Just as importantly, expeditious adjudication of the State's complaint by the district court will assist regulators in maintaining their objective of providing rate stability in pricing decisions in the face of the probable scenario of higher market commodity costs after December 31, 2009.

**III. ASSUMING THE DISTRICT COURT ADDRESSED THE ISSUE OF WHETHER TO STAY THE STATE'S CLAIMS PENDING ARBITRATION (WHICH IT DID NOT), THE COURT DID NOT ABUSE ITS DISCRETION IN POSTPONING A FINAL DECISION ON THE ISSUE.**

**A. A Stay Of Non-Arbitrable Claims Is Not Mandatory.**

Constellation contends that a stay of the State's non-arbitrable claims is mandatory under Section 3 of the FAA. The contention is simply incorrect as a matter of law. Whether or not a trial court should stay non-arbitrable claims pending arbitration rests within the sound discretion of the court; a stay of a non-arbitrable claim is not a matter of right. E.g., Moses H. Cone v. Mercury Const. Corp., 460 U.S. 1, 20 n. 23 (1983) (decision to stay litigation among

non-arbitrating parties pending outcome of arbitration is left to discretion of district court); McCarthy, 22 F.2d at 355 (1st Cir. 1994) (party is not entitled “as of right” to an order staying non-arbitrable claims under 9 U.S.C. § 3 though discretionary stay may be applicable). Sierra Rutilo Ltd. v. Katz, 937 F.2d 743, 750 (2d Cir. 1991) (where a party could not be bound by arbitrable resolution, its non-arbitrable claim will be largely “unaffected by the resolution of the claims . . . in arbitration” and should be addressed by the district court forthwith); In Re: Talbott Big Foot, Inc., 887 F.2d at 614 (FAA mandatory stay provision does not apply to stay claims of a party who is not contractually bound to arbitration provision though discretionary stay may be applicable).

**B. The District Court Acted Well-Within Its Discretion.**

In the Opinion, the court reasoned that it could not “ascertain at this stage and on the briefing submitted whether the parties [*i.e.*, Constellation and Narragansett] agreed, under any of the PPAs, to arbitrate disputes like that presented here” (A-984). Based on these explicit deficiencies of the record, the court postponed ruling on the merits of Constellation’s request to stay “this proceeding” (*i.e.*, Narragansett’s non-arbitrable claims) pending arbitration (A-984). Constellation, the court held, was not foreclosed from seeking such relief in the future with respect to “those PPAs that may eventually be determined to require arbitration of the present dispute” (A-984).

Even if the district court addressed the issue of whether or not to stay the State's proposed claims pending arbitration (which in fact it did not)<sup>6</sup>, the district court did not abuse its discretion in postponing rendering a final decision on Constellation's alleged stay request. By its Order dated February 14, 2007, the district court chose to decide the State's Motion to Intervene at the same time it decided Constellation's Motion to Dismiss Narragansett's complaint (A-785). Constellation did not oppose this procedural methodology.

The record was neither factually nor legally developed regarding the nature of and/or the basis to stay the State's claims pending arbitration when the

---

<sup>6</sup> That in its Opinion the district court did not undertake the legal analysis set forth on Pages 44-48 of Constellation's Brief is further evidence that Constellation did not present the argument to the court in the first place.

Application of this framework, for the first time in this forum, does not favor imposition of a stay pending arbitration of the State's claims. As reflected in the "balance of hardship" analysis supra 24-26, if the State's claims are stayed pending arbitration, then the State's electric ratepayers will likely be prejudiced by "rate shock" that will accompany any adverse decision in the district court. By contrast, Constellation will not be harmed by a denial of the stay. The company is not entitled to avoid expenses associated with litigation when, in all events, it will have to defend the State's claims. The immediate adjudication of the State's claims by the district court, moreover, will not avoid the risk of inconsistent rulings. The State cannot be bound by any hypothetical arbitration that transpires between Constellation and Narragansett. E.g., Am. Renaissance Lines, 502 F.2d at 677. The results of such a process, therefore, cannot "avoid" differing rulings in the State-Constellation litigation. Lastly, the strength of federal policy that favors arbitration is rendered nugatory when the arbitration will not serve as a factual or legal predicate to the resolution of non-arbitrable claims. McCarthy, 22 F.3d at 355 (federal policy favoring arbitration does not extend to situations where party has not agreed to arbitrate).

district court decided Constellation's Motion to Dismiss. Such a stay had not been the focus of Constellation's legal presentation or argument due to the schedule adopted by the court for deciding the State's Motion to Intervene.

Given the premature state of the record in this regard, the district court's decision to postpone rendering a final decision regarding Constellation's stay request, charted the most appropriate procedural course to ensure that the parties could "cull best evidence to support [their] position[s] and present that evidence, together with developed legal argumentation..." to the court. Berkovitz v. Home Box Office, Inc., 89 F.3d 24, 31 (1st Cir. 1996); Giannetta v. Boucher, 981 F.2d 1245, \*9 (1st Cir. 1992) (unpublished opinion) (not postponing a ruling to allow for discovery and proper presentation by party of its position may constitute abuse of discretion). See also Bank One, Texas v. Montle, 964 F.2d 48, 51 (1st Cir. 1992) (district court should give parties the opportunity to employ discovery in order to resolve jurisdictional issue); Bonilla v. Nazario, 843 F.2d 34, 37 (1st Cir. 1988) (party must be given an opportunity through a full development of the record to tell the court what they intend to prove and how); 5B C. Wright & A. Miller, Federal Practice & Procedure § 1357 (2004) (district court has discretion to postpone deciding a motion to dismiss until some later stage in the proceedings). In exhibiting hesitancy to "leapfrog" to the merits of Constellation's request for stay, the

district court displayed a high regard for “established protocol, ” see Stella v. Town of Tewksbury, Massachusetts, 4 F.3d 53, 55 (1st Cir. 1993), and assiduous adherence to the court’s previously adopted “procedural course.” See Leyva v. On the Beach, Inc., 171 F.3d 717, 720 (1st Cir. 1999). The district court’s decision to postpone a final ruling on Constellation’s alleged request for stay of the State’s claims, therefore, does not remotely fall within the pale of an abuse of discretion.

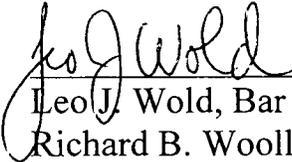
**CONCLUSION**

For the reasons set forth herein, Constellation’s entire appeal should be dismissed and/or denied.

Respectfully submitted,

State of Rhode Island and Providence  
Plantations and the Rhode Island  
Division of Public Utilities and Carriers  
By their Attorney,

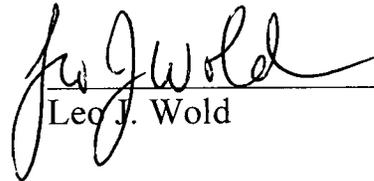
Patrick C. Lynch  
Attorney General

  
\_\_\_\_\_  
Leo J. Wold, Bar No. 26048  
Richard B. Woolley, Bar No. 51575  
Department of Attorney General  
150 South Main Street  
Providence, Rhode Island 02903  
Tel: (401) 274-4400, ext. 2218  
Fax: (401) 222-3016

Dated: April 4, 2008

**CERTIFICATE OF COMPLIANCE WITH**  
**TYPE – VOLUME LIMITATIONS**

Pursuant to F.R.A.P. 32(a)(7)(c), I hereby certify that the foregoing Brief is printed in plain 14 point Times New Roman type, save where emphasis or rules of citation require otherwise. Excluding cover, table of contents, table of authorities, signature and certificates of compliance with type-volume limitations and of service of filing, it contains 6,891 words as counted by Microsoft Word's tool menu.

  
\_\_\_\_\_  
Leo J. Wold

**CERTIFICATE OF SERVICE**

I certify that on this 4<sup>th</sup> day of April, 2008, a copy of this Brief and the accompanying CD were forwarded by regular mail, postage prepaid, to the following counsel of record as follows:

Kenneth W. Irvin, Esq.  
Teresa M. Goody, Esq.  
Paul Thompson, Esq.  
McDermott Will & Emery, LLP  
600 13<sup>th</sup> Street, N.W.  
Washington, DC 2005-3096

Gerald J. Petros, Esq.  
Robin L. Main, Esq.  
Anna M. Piazza, Esq.  
Hinckley, Allen & Snyder LLP  
50 Kennedy Plaza  
Providence, RI 02903

Stacy P. Nakasian, Esq.  
Duffy Sweeney & Scott, Ltd.  
One Turks Head Place, Suite 1200  
Providence, RI 02903

  
Robin DiMeglio



1           THE COURT: Good morning. We're here this  
2 morning in the Narragansett Electric Company versus  
3 Constellation Energy Commodities Group, Inc.

4           We are here on the motion by the State of Rhode  
5 Island to intervene in this matter.

6           So let's begin by having the parties identify  
7 themselves for the record, please.

8           MR. PETROS: Jerry Petros for the Narragansett  
9 Electric Company.

10          MR. WOLD: Leo Wold, W-O-L-D, for the State of  
11 Rhode Island and Providence Plantations, and the Rhode  
12 Island Division of Public Utilities and Carriers.

13          MR. IRVIN: Good morning. Kenneth Irvin of the  
14 law firm of McDermott, Will & Emery from Washington,  
15 D.C. It's Irvin, I-R-V-I-N. Thank you again for  
16 allowing us to appear special.

17          MS. NAKASIAN: Good morning, your Honor. Stacey  
18 Nakasian on behalf of Constellation Energy.

19          THE COURT: You have a pro hac motion. I've  
20 granted that, right?

21          MR. IRVIN: You have your Honor, yes.

22          THE COURT: Okay. Good. You said appear  
23 specially. I wasn't sure if you just meant special as  
24 in pro hac or just otherwise special. All right.

25          MR. IRVIN: Not special as a student in school,

1 your Honor.

2 THE COURT: All right. Well, we're here on the  
3 State's motion. I'll give everybody a chance to  
4 participate, but it probably makes sense to hear from  
5 the State first and then -- it's up to you, but perhaps  
6 we could have Narragansett argue after the State, and  
7 then you can sort of take on both arguments, if you're  
8 comfortable with that.

9 MR. IRVIN: That would be fine with us, your  
10 Honor.

11 THE COURT: Okay. Begin with the State.

12 MR. WOLD: Your Honor, good morning. The matter  
13 is here, as your Honor mentioned, on the State's motion  
14 to intervene.

15 THE COURT: Could I just interrupt you for a  
16 moment.

17 MR. WOLD: Yes, your Honor. I want to make sure  
18 that nobody has any difficulty whatsoever with my  
19 handling a matter in which I guess potentially there  
20 could be an impact on rates, which I, as a ratepayer,  
21 might see either increased or not increased depending  
22 on a ruling that I make. This is not dissimilar to  
23 other kinds of things that come up where everyone is a  
24 potential member of a class, that sort of thing, but  
25 I'd like to just get your positions on the record on

1       that point.

2               MR. WOLD: The State would have no problem with  
3 your handling this matter, your Honor.

4               THE COURT: All right.

5               MR. PETROS: Narragansett has no objection, your  
6 Honor.

7               MR. IRVIN: Constellation has no objection, your  
8 Honor.

9               THE COURT: All right. Then I don't feel that  
10 my status as a ratepayer, every judge in the district  
11 would be a ratepayer, and I don't feel that that is a  
12 reason to recuse, and I don't think any of the parties  
13 feel that way either so we've covered that. Why don't  
14 you go ahead.

15               MR. WOLD: Thank you, your Honor. Before I  
16 address the merits of the motion to intervene, I just  
17 wanted to try to scope the framework of the argument.

18               As I understand from the Court's scheduling  
19 order, we're not here this morning to argue subject  
20 matter jurisdiction of the Court or the impact of the  
21 arbitration provision in connection with the instant  
22 motion. The matter is here on the motion to intervene  
23 and to join claim.

24               THE COURT: Well, generally, I think that's  
25 true, but Constellation has certainly raised those

1 issues as part of their objection to the motion to  
2 intervene, so, you know, I think you might -- that  
3 might just be your argument. I might be in agreement  
4 with that, but the appropriate time to hear issues  
5 regarding whether, for example, the impact of the  
6 arbitration agreement on the motion to intervene, for  
7 example, should the arbitrator decide this question,  
8 for example, that's something that that argument is not  
9 well-founded. You might want to deal with that.  
10 They're making that argument here. I think you might  
11 want to deal with it.

12 As far as subject matter jurisdiction goes, I  
13 think you do have to address that to a degree, because  
14 Constellation has made a challenge to the State's right  
15 to assert Count III, I think it is, on the estoppel  
16 based on lack of subject matter jurisdiction. So I'll  
17 leave it to you how much you want to address.

18 MR. WOLD: Let me turn to two of the issues that  
19 they did raise in their response to our motion to  
20 intervene, the issue of arbitration provision. It's  
21 the State's position with respect to that contention  
22 that it has no impact whatsoever on the State's  
23 proposed claims against Constellation. Our claims are  
24 based on the order of FERC, a direct action against  
25 Constellation. It's the State's position that

1 Constellation is bound by that FERC order, and the  
2 State is also bound by that FERC order. So whatever is  
3 taking place in connection with the PPAs relating to  
4 arbitrability has no impact, bearing or relevance with  
5 respect to the State's case against Constellation.

6 They've also raised in their response papers the  
7 issue of the State's putative -- being an incidental  
8 beneficiary under the PPAs. I would represent to the  
9 Court this morning that that is not the State's  
10 contention in connection or as raised in the proposed  
11 complaint.

12 Again, the State's case against Constellation is  
13 based on their violation of a FERC order and conduct  
14 prior to the entry of that order by FERC, which the  
15 State alleged caused the State to change its position,  
16 namely, they, through representations, conduct, and  
17 inaction to a representative of the State, for an  
18 administrative law judge who was undertaking  
19 negotiations and discussions on behalf of FERC, caused  
20 the State to enter into a settlement agreement, which  
21 was then subsequently approved by FERC.

22 So those two arguments by Constellation it's the  
23 State's contention, we believe, the Court can quickly  
24 dismiss.

25 In connection with the issue of subject matter

1 jurisdiction, your Honor, we would prefer to address  
2 that in connection with the motion to dismiss that is  
3 going to be heard on March 5th.

4           However, I would state a careful review of most  
5 of the cases cited in Constellation's papers do not  
6 stand for the propositions which they have alleged.  
7 Those cases are claims for damages where the filed rate  
8 is contrary or is contradicted by the claim for  
9 damages. That's not what's occurring here. The State  
10 is bringing a declaratory judgment action to enforce  
11 tariffs that were on file with FERC.

12           So we do not believe that the cases cited in  
13 connection with their asserted claim that the Court  
14 does not have subject matter jurisdiction apply in this  
15 case.

16           Turning then to the motion to intervene, when  
17 all is said and done, Constellation, essentially,  
18 alleges that the State has not been injured and will  
19 not incur imminent injury. It's the State's contention  
20 that it has been injured. It's been injured  
21 dramatically and substantially by the representations,  
22 conduct and inaction of Constellation before the FERC  
23 ALJ and before the FERC.

24           To give you some understanding of what these  
25 representations and inaction were, on January 31st,

1 Constellation orally represented to an ALJ, and it's in  
2 reports that the ALJ made to FERC, that they would  
3 oppose a settlement. That's what the ALJ thought.

4 Subsequently, on April 11th, the ALJ reports to  
5 FERC that three of the parties listed in my prior  
6 report, having indicated at that time that they would  
7 oppose the settlement, did not, in the end, oppose it.

8 The ALJ and the State and others who are  
9 participating in these negotiations and were carefully  
10 monitoring what Constellation's position was in  
11 connection with the settlement believed by the time  
12 that certainly the State signed the agreement, and  
13 thereafter, that Constellation did not oppose the  
14 settlement.

15 FERC subsequently approved the settlement based  
16 on these representations from the ALJ, and I might also  
17 add, representations directly between Constellation and  
18 the State, which we will, again, address in connection  
19 with our motion to dismiss.

20 So the State's change of position based on those  
21 representations we executed the settlement agreement is  
22 a substantial and dramatic injury. We cannot put the  
23 genie back in the bottle and now reassume our prior  
24 strong negotiating position that we had in connection  
25 with the FERC settlement. Can't be done.

1 Further, the State's injuries in this case are  
2 both substantial and imminent. They're ongoing.  
3 Constellation has brought or is about to launch a  
4 lawsuit against Narragansett Electric in excess of  
5 \$100,000,000. If that amount of money is ultimately  
6 charged to Narragansett Electric, Constellation  
7 prevails, that sum of money will be passed on to  
8 ratepayers. Constellation attempts to argue somehow  
9 that --

10 THE COURT: I'm going to have to stop you,  
11 because I'm afraid that I'm just, maybe just not  
12 following you very well, and it's probably my fault and  
13 not yours, but I'm really -- I guess I'm not really  
14 sure what you're getting at. I thought that this  
15 action was an action between Narragansett Electric and  
16 Constellation having to do with the interpretation of a  
17 contract. And there are a lot of issues about that,  
18 whether there's -- contract should be sent to  
19 arbitration, and if not, a number of issues.

20 Now, you want to intervene, as I understood it  
21 from your papers, I thought the State's argument with  
22 respect to intervention was that the ratepayers of the  
23 State need a voice in this action, need to be protected  
24 from the potential impact of whatever the outcome of  
25 that contract dispute might be because if Constellation

1 is correct in the assertions that are being made here,  
2 that there would be a very substantial cost, which  
3 would -- or liability by Narragansett, which would be  
4 potentially passed through to the ratepayers. And I  
5 thought that the argument of the attorney general and  
6 the division was that you cannot rely on Narragansett  
7 Electric to represent effectively the interest of the  
8 public and the ratepayers.

9 And, of course, Constellation says, well,  
10 there's a process, the PUC rate-making process is  
11 enough protection for ratepayers to give the PUC or the  
12 division the opportunity to assess whatever costs might  
13 be imposed potentially on ratepayers through or as a  
14 result of this contract. And I thought you say and  
15 reply to that, and Narragansett Electric says, no, the  
16 statute actually allows for a sort of direct  
17 pass-through here so that the real opportunity for  
18 acting as kind of the filter to protect the ratepayers  
19 is in this Court.

20 Now, I thought that's what this motion to  
21 intervene was about. And I guess I'm not really sure  
22 what you're talking about and how that relates to this  
23 argument. So you've got to kind of get, either get me  
24 straightened out about what this is about, or you've  
25 got to get straightened out and address those

1 questions.

2 MR. WOLD: Your Honor has summed up the entire  
3 merits of the motion to intervene, but the case the  
4 State is seeking to bring against Constellation and  
5 also that Narragansett has already brought in  
6 connection with their complaint is really two  
7 components. One has to do with Narragansett's rates  
8 under the PPAs, the contractual matters that exist  
9 between Narragansett Electric and Constellation. But  
10 the second component, which relates to Count I and  
11 Count II of the State's proposed complaint and also  
12 Count III of the State's proposed complaint and Counts  
13 I and II of Narragansett Electric's complaint, has to  
14 do with the FERC order that was entered in June of  
15 2006. And it is with respect to that FERC order that  
16 the State and Narragansett Electric is seeking  
17 declaratory relief from the Court asserting that that  
18 order constitutes a bar to Constellation's attempt to  
19 obtain capacity payments from Narragansett Electric.

20 So, yes, there is the contractual matters  
21 relating between Narragansett and Constellation, but  
22 those have nothing to do with another defense that  
23 Narragansett has, the FERC order, and it is that same  
24 bar under that order that the State is asserting  
25 against Constellation.

1           Since the Court has already summarized the  
2           entire merits of the motion to intervene and succinctly  
3           encapsulated the entire arguments of the State, to wit,  
4           that, under Rhode Island General Laws, any award  
5           against Narragansett Electric is simply a pass-through,  
6           and therefore, any action by the Rhode Island Public  
7           Utilities Commission would have utterly no impact on  
8           the standing of the State in this matter, I do not  
9           believe I have anything further to add in connection  
10          with the motion to intervene.

11           THE COURT: I guess what I want to know from you  
12          is why can't the PUC, as part of its regulatory  
13          oversight of rates by Narragansett Electric, why  
14          doesn't it have enough authority in that process, to  
15          protect the ratepayers and to, potentially, decline to  
16          pass-through these rates or only pass-through some of  
17          these rates or otherwise control rates in a way that  
18          sufficiently protects the ratepayers?

19           MR. WOLD: With respect to three of the  
20          contracts, as your Honor noted, it's a pass-through.  
21          The State PUC is bound by Rhode Island law, and that  
22          law basically allows the State PUC to conduct, with  
23          respect to one contract, prudence review. But it is  
24          certainly silent in connection with that issue with  
25          respect to the other three contracts. So really what

1 takes place before the PUC with respect to three of the  
2 contracts is a very formal type of filing, which  
3 ultimately, if the costs are assessed against  
4 Narragansett Electric, they are simply passed through  
5 to ratepayers.

6 The State PUC is bound, just as any other agency  
7 is, by the law of the State of Rhode Island, and that  
8 law simply does not allow the State PUC to simply  
9 disallow costs that Narragansett has filed with the PUC  
10 and states that it has legitimately incurred. For a  
11 number of public policy reasons that could ultimately  
12 end up as being disastrous to the functioning and  
13 operations of the company.

14 THE COURT: So you're saying under 39-1-27.3(b)  
15 -- I take it (b)(4), because these costs relate to  
16 power supply arrangements made after January 1, 2002, I  
17 think most of these contracts fall after that date,  
18 maybe one doesn't, if I recall correctly, because they  
19 relate to or qualify under that subsection, they are  
20 entitled to recover costs without -- so those costs  
21 can't be examined.

22 MR. WOLD: It's the State of Rhode Island's  
23 belief, based on its best reading of the statute, and  
24 obviously, the Rhode Island Supreme Court is the  
25 arbiter of that statute, but we believe that the bulk

1 of the costs will be passed through to ratepayers.

2 With respect to one of the contracts, the one  
3 entered into or executed after the January 1st, 2002  
4 deadline, there is an indication in the statute that  
5 there could be some prudence review by the Rhode Island  
6 Public Utilities Commission. However, there is utterly  
7 no evidence at this stage that Narragansett Electric  
8 has engaged in imprudent behavior. Utterly no  
9 evidence. So those costs would be passed through as  
10 well.

11 The Rhode Island PUC cannot simply disallow  
12 costs on an arbitrary and capricious manner. There has  
13 to be some sound, reasonable basis for doing so, and it  
14 also has to be authorized by statute. None of those  
15 cases or conditions exist in the case at bar.

16 THE COURT: Okay. Thank you.

17 MR. WOLD: Thank you, your Honor.

18 THE COURT: Mr. Petros, do you want to go next?

19 MR. PETROS: Sure, your Honor. Your Honor, I  
20 think the arguments are fairly well laid out in the  
21 papers, but let me make a few observations that might  
22 be helpful to the Court.

23 First, as I think Mr. Wold indicated, while  
24 certainly one aspect of this claim is Narragansett  
25 Electric Company's position, that under the PPAs

1 Constellation is not entitled to recover the capacity  
2 costs that it seeks. As Mr. Wold pointed out, the  
3 second count in our complaint and one of our claims is  
4 that in addition to the PPA issue, Constellation is  
5 barred by Section VIII(A) of the FERC settlement order  
6 and cannot recover capacity costs because of,  
7 essentially, the regulatory impact of that order.

8 And then both the State -- we have a waiver  
9 claim and the State has an estoppel claim as sort of a  
10 third-party claim. But certainly with respect to that  
11 second element, the settlement order, the State's  
12 before the Court saying that pursuant to Section  
13 VIII(A) of the settlement order, Constellation cannot  
14 recover these capacity costs, and as a state, we need  
15 to intervene to protect the interests of our  
16 ratepayers.

17 Now, I think the Court asked the right question,  
18 which is are those interests really at issue, really at  
19 stake in this controversy or dispute. And I guess I  
20 would answer that question, I'd answer it yes, and I  
21 would analyze it in this way, your Honor. It is not  
22 for this Court this morning, I don't believe, to  
23 determine in a final judgment or with 100 percent  
24 certainty whether or not the ratepayers will have to  
25 absorb every penny of capacity costs that Constellation

1 may recover as a result of this dispute or may not  
2 recover.

3 If you look back at the standard, your Honor,  
4 which is not in dispute here in terms of intervention,  
5 particularly elements B and C or two and three, they  
6 say, (Reading:) The movant must claim an interest  
7 relating to the property or transaction which is the  
8 subject of the action. And then C, The movant must be  
9 so situated that the disposition of the action may, may  
10 as a practical matter, impair or impede his ability to  
11 protect that interest.

12 Now, I don't think there can be any real  
13 dispute, your Honor, that the State of Rhode Island has  
14 an interest in the transaction that is before the  
15 Court, which is whether or not Constellation can  
16 recover what it contends could be as much as 100 to  
17 \$150 million in capacity costs or some portion of those  
18 additional costs that they allege.

19 And similarly, I don't think there can be any  
20 real dispute that, as a practical matter, the recovery  
21 of that money by Constellation may impair the rights of  
22 the State of Rhode Island, particularly the ratepayers.

23 In fact, your Honor, I would say there's  
24 overwhelming evidence as it stands right now, as a  
25 matter of law, that the costs under three of those

1 contracts pass through to the ratepayers without  
2 discretion on the part of the Public Utilities  
3 Commission to say that those costs were imprudently  
4 incurred, and therefore, we're not going to pass them  
5 through.

6 Your Honor, I think the Court referred to  
7 subsection 4. I think if the Court looks back at that  
8 statute, it's actually subsection 1 that applies to the  
9 first three contracts. Subsection 1 refers to  
10 wholesale standard offer supply agreements with power  
11 suppliers in effect prior to January 1, 2002. Three of  
12 these power purchase agreements were, in fact, signed  
13 and in effect prior to 2002. I think two were signed  
14 in '98 and one might have been signed in 2001, but I'm  
15 quite sure that three were in effect prior to 2002.

16 So with respect to those three, not only is it  
17 likely, not only is it likely that they will be passed  
18 on, but I think, based on what we know today, that  
19 almost certainly, as a matter of law, any costs  
20 recovered by Constellation under those contracts for  
21 capacity costs will be passed on to the ratepayers.

22 THE COURT: But is there any argument that the  
23 State could make in the context of this case that can't  
24 be made just as effectively by Narragansett Electric?

25 MR. PETROS: Well, as I look at the cases on

1 that, your Honor, I think the answer to that question  
2 is this. Certainly, I would hope that Narragansett has  
3 retained competent counsel here and will argue the case  
4 aggressively and properly before the Court and make the  
5 right arguments, I would hope. But I think if you look  
6 at what the cases say, what they say is they look at  
7 the status of the parties and the positions of the  
8 parties. And in this case, when you look at it really  
9 very practically, the ratepayers are the real parties  
10 in interest here.

11           Ultimately, if, in fact, what I just said to the  
12 Court is correct, and I certainly believe it is  
13 correct, your Honor, these costs will pass through, the  
14 ratepayers are the real party-in-interest. And I think  
15 when the courts look at intervention, they look at the  
16 interest of the parties and say, okay, well, the real  
17 party-in-interest should have a seat at the table.  
18 They should be able to participate in the controversy  
19 to protect their interest and to be properly motivated  
20 to do so.

21           I mean, I suppose the State could say perhaps  
22 Narragansett won't argue as vigorously as we will,  
23 because, for the reasons I just said, Narragansett is  
24 going to say, well, if I lose here, I get it back over  
25 here on the pass-through. I think if you look at the

1 intervention cases, what you'll find, your Honor, is  
2 that courts in that situation say the real  
3 party-in-interest, in this case the potential payee,  
4 should have a seat at the table, should have a seat in  
5 the courtroom, should participate in the action so at  
6 the end of the day they're not saying we don't think  
7 Narragansett properly, you know, preserved our  
8 interest.

9 Your Honor, I did find one case, if I can give  
10 the Court a cite. This is a case that may be cited in  
11 connection with the motion to dismiss as well later on,  
12 but there is a very similar case. It is a Fifth  
13 Circuit case. The citation is 824 F.2d 1465. It's a  
14 1987, Fifth Circuit decision that on this point is very  
15 similar where they allowed, essentially, the PUC in  
16 that State, which was called the Public Service  
17 Commission, to intervene finding that it really must  
18 intervene to protect the interest of the ratepayers.  
19 It was a very similar situation where the distributor,  
20 Narragansett Electric in that case, was suing a  
21 supplier, Constellation in this case, and they had a  
22 fight about what rates should be and what some other  
23 issues should be under power purchase agreements. Very  
24 similar to what we have here.

25 And in that case, the Fifth Circuit said clearly

1 intervention should be allowed on the part of the  
2 commission. They have to have a seat at the table to  
3 protect the ratepayers. If they wait until that  
4 dispute is determined, it becomes res judicata as to  
5 them is what the circuit said, and they have no  
6 meaningful way to protect the ratepayers in the rate  
7 proceeding that might follow that. It's a very similar  
8 case.

9 THE COURT: Wouldn't one of the arguments from  
10 Constellation be that, while there may be a  
11 pass-through here, that the overall ability of the PUC  
12 to govern rate applications by Narragansett would, as a  
13 practical matter, give it the ability to limit other  
14 rate increases that Narragansett might request for  
15 other reasons over which it has complete jurisdiction?  
16 So as a practical matter, Narragansett is going to  
17 fight as hard as it possibly can to prevent every  
18 single dollar of pass-through, because they know,  
19 practically speaking, they're only going to get so much  
20 out of the PUC. And if all of this is passed through,  
21 the PUC may take it out in some other rate filing  
22 Narragansett makes.

23 Now, you know, you can say, well, they really  
24 need to look at these things very separately and they  
25 wouldn't do that, but --

1 MR. PETROS: I think that's true, your Honor.  
2 As a matter of statutory authority and directive, the  
3 PUC, as a matter of law, cannot say, okay, because I  
4 had to pass these costs through, I'm going to rule some  
5 cost over here that otherwise would be prudent, I'm  
6 going to say that Narragansett can't collect them.

7 I don't think that Constellation can, in good  
8 faith, advance an argument that the PUC would ignore  
9 it's statutory obligation to follow the law and apply  
10 the appropriate standards laid down by both the General  
11 Assembly and the Supreme Court. So your Honor, no, I  
12 don't think they can, you know, steal from Peter to pay  
13 Mary or whatever that analogy is, Judge. I think that  
14 this issue stands on its own, and I think that the  
15 ratepayers clearly have an interest, I think probably a  
16 dominant interest in this dispute.

17 And again, your Honor, with respect to the  
18 particular count that is common here that the Court  
19 pointed out, there's a settlement order, Section  
20 VIII(A). The State asserts, and I think correctly,  
21 that Section VIII(A) prevents Constellation from  
22 obtaining the capacity costs they seek to recover from  
23 Narragansett Electric Company.

24 The State is absolutely a proper party to make  
25 that argument.

1           THE COURT: Why can't Narragansett make that  
2 argument under Section VIII(A)?

3           MR. PETROS: We can and we will, your Honor, but  
4 there's no rule of law that says because one party is  
5 making an argument another party can't. You know, I  
6 think the State on its own could have filed a separate  
7 action, and I suppose could file a separate action  
8 under Section VIII(A) or to enforce the bar in Section  
9 VIII(A), and it wouldn't make much sense to have two  
10 actions of that type pending in different courts  
11 between different parties. They should be joined.  
12 It's essentially the same issue. For all the  
13 efficiency reasons, they should be together.

14           And again, your Honor, in terms of the interest  
15 involved, I think, if anything, the ratepayers have  
16 perhaps a stronger interest, because, ultimately, based  
17 on what we know today, they're likely to bear the  
18 burden if, in fact, Constellation is successful here.

19           And again, your Honor, I go back to the  
20 standard. The standard doesn't say that they have to  
21 show with 100 percent certainty that, in fact, their  
22 rights will be impaired. The standard is a fairly  
23 broad standard and says that if it's possible, if it  
24 may impact or impair their rights, then they should be  
25 allowed to intervene. And I think that's a sensible

1 standard to protect the rights of parties so that those  
2 rights aren't unintentionally taken away when the party  
3 had no right to participate. And I think the  
4 intervention policy is to allow parties who arguably  
5 have an interest in the matter to, in fact, participate  
6 so that at least their rights are exonerated or  
7 determined in the proceeding.

8 Your Honor, just if I may, just one or two other  
9 brief points. There are one or two statements in the  
10 Constellation brief that I think I want to address just  
11 very briefly.

12 On page four of Constellation's memorandum, they  
13 say in the middle of the page in the first full  
14 paragraph that (Reading:) To intervene as a right, the  
15 State must demonstrate it holds an interest in  
16 Constellation's right to an equitable adjustment that  
17 is legally cognizable, proprietary and significantly  
18 protectable.

19 I couldn't imagine a statement that's more wrong  
20 than that one. The State doesn't have to demonstrate  
21 it has any interest in Constellation's right to an  
22 equitable adjustment. To the contrary. The State is  
23 here asserting that Constellation has no right to an  
24 equitable adjustment because Section VIII(A) was added  
25 to the settlement order specifically to ensure that

1 Constellation was not in here asking for what it's  
2 asking for now. They don't make that claim. That's  
3 really a very inaccurate statement of what the State  
4 asserts and what its position is here.

5 They are here under Section VIII(A) saying,  
6 Judge, give us the opportunity to ask this Court to  
7 enforce an order by FERC, and particularly Section  
8 VIII(A), and give us an opportunity to show the Court  
9 that Constellation cannot recover capacity costs under  
10 that order. And I think it's a very direct claim.  
11 They should be entitled to intervene, I think, and  
12 assert their rights under that claim. Unless the Court  
13 has any more questions, I'll sit down.

14 THE COURT: Do you have anything to say about  
15 this argument they make with respect to the filed rate  
16 doctrine?

17 MR. PETROS: I do, your Honor. This is an area  
18 I'm sure we'll discuss in some detail when we get to  
19 the motion to dismiss, but let me sort of address it  
20 simply.

21 There's another statement that goes to this,  
22 that same issue that they make in their brief. If you  
23 look at page seven of Constellation's brief, and I'll  
24 just read it briefly, your Honor, the very last  
25 sentence on page seven they say, (Reading:) Granting

1 relief on those claims depends not on the Court  
2 enforcing a clear, unambiguous FERC order, but rather  
3 on the Court presuming that FERC would find it  
4 reasonable to bar Constellation from seeking an  
5 equitable adjustment in light of Rhode Island's support  
6 for the settlement agreement.

7           Again, your Honor, that is a misstatement of  
8 what is happening here. Narragansett Electric has  
9 brought this claim. We make three claims, your Honor.  
10 We argue that, number one, under the power of purchase  
11 agreements, the contracts, the private contracts the  
12 Court referred to earlier, Constellation is not  
13 entitled to recover capacity costs. Those are fixed  
14 price contracts. Those contracts specifically say that  
15 Constellation will be responsible for capacity costs.  
16 The parties allocated those costs to Constellation.

17           So, number one, we make that argument. The  
18 filed rate doctrine has absolutely no application to  
19 that argument. It's a contract between the parties,  
20 and Narragansett is asserting its rights under those  
21 contracts.

22           Number two, we argue that under Section VIII(A),  
23 which, essentially, specifically says that wholesale  
24 power suppliers like Constellation will not change,  
25 essentially, or try to recover the additional capacity

1 costs that they will incur during the transition period  
2 from companies like Narragansett Electric Company, the  
3 distributors. Section VIII(A) says that.

4 We are in this Court arguing under Section  
5 VIII(A) this Court should enforce that FERC order and  
6 rule that Constellation cannot recover those costs.  
7 There's no way in which that argument implicates the  
8 filed rate doctrine. We're not asking this Court to  
9 affect the rate, or amend the rate, or change the rates  
10 and do something that only FERC can do. We're asking  
11 this Court, under the jurisdictional cases which we've  
12 cited, I think the Federal Power Act, I forget the name  
13 of the Act, your Honor, it's in our motion to dismiss  
14 memorandum, that Act and the cases under that Act  
15 clearly and unequivocally say that district courts  
16 enforce FERC orders. We're not asking -- we don't  
17 contend that the FERC order is ambiguous or unclear.  
18 It couldn't be more clear. And it clearly bars  
19 Constellation from doing what they're doing.

20 You may hear them say it's ambiguous and  
21 unclear, because they don't like what it says, but we  
22 don't assert that, your Honor. And it's clear under a  
23 myriad of case law that the Court has the right to  
24 enforce and, indeed, is the proper party to enforce  
25 FERC orders. So that doesn't implicate the filed rate

1 doctrine.

2 And the third argument, your Honor, is our  
3 waiver claim, and again, that does not implicate the  
4 filed rate doctrine either.

5 Constellation is trying to say, you know, that  
6 because we don't want them to recover the capacity  
7 costs, we're seeking somehow a change in the rates and  
8 that's inappropriate because that can only come through  
9 FERC or through some other regulatory proceeding. We  
10 don't believe there's any FERC jurisdiction implicated  
11 in this action. We look forward to arguing that in  
12 more detail when the papers are fully filed in the  
13 motion to dismiss, but we think it's a non-starter,  
14 your Honor.

15 THE COURT: Your argument would be that this is  
16 entirely premature to put forward that argument and as  
17 well as the arbitrability argument that they make in  
18 the context of the intervention motion, and those are  
19 things that really should be argued, and you would say  
20 rejected in the context of the motion to dismiss  
21 argument that is scheduled for March.

22 MR. PETROS: That's exactly right, your Honor.  
23 And if I may add, you mentioned the arbitrability  
24 argument. It really is very similar. When you think  
25 about the three claims I just outlined, what

1 Narragansett is asserting in this complaint is that the  
2 equitable adjustment, as they call it, those words  
3 don't appear in the contract, I don't believe, but the  
4 adjustment for a change of market rules that  
5 Constellation seeks in this action they aren't entitled  
6 to, because, one, they're not entitled to it under the  
7 power of purchase agreements; two, they're barred from  
8 getting it under the confirmatory language in the  
9 settlement order; and three, they waived it.

10 Now, beyond that, your Honor, if you look at the  
11 contracts themselves, it is clear that two of the  
12 contracts, undisputed that two of them don't provide  
13 for mandatory arbitration. One of them does, and the  
14 fourth one there's a dispute about whether arbitration  
15 is required under that. But in either instance, your  
16 Honor, the arbitration is there to determine what the  
17 adjustment should be, if any, if an adjustment is  
18 appropriate.

19 We're not asking the Court to determine in this  
20 action what adjustment is appropriate. It may well be  
21 that that issue, if we ever get to it, does go to  
22 arbitration. We are saying to this Court they don't  
23 get there, they're not entitled to adjustment as a  
24 matter of law under the contracts, under the settlement  
25 order and because of a waiver issue. None of those

1 issues are subject to arbitration under any of the  
2 contracts, even the one contract that has a mandatory  
3 arbitration provision. So as a threshold matter, the  
4 Court, I think, needs to determine in this action  
5 whether Constellation is entitled to any adjustment.  
6 And then, if the Court determines that they are, then  
7 perhaps at that time the arbitration issue becomes ripe  
8 in terms of who should make that adjustment, a court or  
9 an arbitrator, because under one contract an arbitrator  
10 would make that adjustment; under two, he clearly  
11 wouldn't; under a third, we may argue about it at some  
12 point in time. But that whole arbitration issue is not  
13 only premature in terms of the motion to intervene, but  
14 it's premature in terms of the whole status of the  
15 case.

16 We are asserting, on behalf of Narragansett  
17 Electric Company, they're simply not entitled to  
18 adjustment for those three reasons I've discussed.  
19 Thank you, your Honor.

20 THE COURT: Thank you. All right.

21 MR. IRVIN: Good morning, your Honor. Kenneth  
22 Irvin for Constellation. It's clear the Court has hit  
23 upon the central issues here, and I want to try and  
24 pick up where you left off with the State and then come  
25 back to the discussion with Narragansett, because most

1 remarkably, from my perspective in terms of this  
2 intervention question, both the State and Narragansett  
3 just presented the same arguments. And I think the  
4 Court is grappling with the question of whether there's  
5 an inadequacy of representation of ratepayers' interest  
6 here that would warrant the State intervening. And  
7 having the State intervene is not a free option. It  
8 comes with consequences. The case will be delayed. It  
9 will be protracted. It will suffer from increased  
10 complexity as it now becomes a three-way fight or a  
11 two-on-one fight as opposed to the bilateral  
12 contractual dispute that we think is really the core of  
13 the matter.

14 THE COURT: Why will it delay things? I don't  
15 understand that argument.

16 MR. IRVIN: I expect that, as an intervenor, the  
17 State would intend to prosecute it's rights to conduct  
18 discovery, to be heard on all matters brought before  
19 the Court and so the delay would be attendant to just  
20 having it be a three-party -- two parties against  
21 Constellation type of litigation as opposed to the  
22 bilateral contractual dispute that we think the real  
23 crux of the matter is.

24 The interests of the ratepayers are adequately  
25 protected by the prudency review that the Rhode Island

1 Public Utilities Commission can conduct. It's  
2 interesting that the State never really affirmatively  
3 conceded that any costs incurred under three of the  
4 four PPAs are not subject to any review by the State.  
5 The State counsel hedges on that, says the Rhode Island  
6 Supreme Court hasn't passed on that question. Not  
7 surprisingly, Narragansett would like to pre-suppose  
8 that it's an automatic pass-through, but that would be  
9 an extraordinary abdication by the Legislature of the  
10 responsibilities of the Public Utilities Commission to  
11 ensure that ratepayers are not charged for imprudent or  
12 unreasonably incurred costs.

13 There's also another provision of the statute  
14 that the State cites which provides expressly that any  
15 allowance of costs could be done over a period of time.  
16 As is commonly done in retail rate-making proceedings,  
17 the recovery of a cost could be extended over an  
18 extended period of time to ease the burden, if you  
19 will, and thus the State does have some discretion,  
20 even if it has no prudence review, it does have some  
21 discretion on how to --

22 THE COURT: That doesn't answer the question of  
23 whether it's a strict pass-through or not. I mean, the  
24 fact that you could finance something over a period of  
25 time doesn't mean you don't have to pay for it. It

1 just means that it takes longer, maybe costs more. I  
2 mean, I don't know what argument Narragansett would  
3 have to interest on the pass-through if it was forced  
4 to recover those costs over a ten-year period as  
5 opposed to all at once, and that might result in a  
6 fight between Narragansett and the division, but the  
7 plain language of the statute that's been cited to me  
8 would appear to indicate that this is a mandatory  
9 pass-through, will be entitled to recover costs arising  
10 out of agreements like this.

11 I think the PUC would be hard-pressed to tell  
12 Narragansett Electric that, if you prevail, that  
13 they're not entitled to pass that cost through to the  
14 ratepayers. I can't see how they would have any  
15 authority to do that. I can't see how the State  
16 Supreme Court would allow them to do that if they  
17 decided to do it in the face of that statute.

18 So is there another part of this statute that  
19 I'm missing that would mitigate that very plain and  
20 very sort of explicit language?

21 MR. IRVIN: Well, your Honor, I continue to  
22 doubt whether this statute does, indeed, effectuate a  
23 complete abdication of the PUC's retail rate-making  
24 authority. That is surprising. And it would seem to  
25 use an absurd hypothetical should Narragansett incur

1 something that was outlandish under these contracts  
2 that everyone would most certainly agree was  
3 outlandish, to say then that this language from the  
4 Rhode Island Legislature would allow a straight  
5 pass-through would fly in the face of convention.

6 So I don't accept that when the Rhode Island  
7 Supreme Court comes to look at this language that it  
8 will indeed conclude that the Legislature just  
9 completely abdicated any prudence review. But even if  
10 you accept that the Legislature appears to do that,  
11 that's the source of the State's injury here, if any.  
12 I'm confident that any allowance in favor of  
13 Constellation at the end of this dispute will have been  
14 deemed to have been prudently incurred because  
15 Narragansett is a fully capable litigant. They're  
16 going to defend ratepayer interest because they know  
17 they're at risk. Even if they have a textual argument  
18 based on this legislation, they don't want to incur the  
19 wrath of the Public Utilities Commission; they don't  
20 want to incur the wrath of ratepayers. They have to  
21 live in this town. And so they're going to use their  
22 best judgment, their best efforts to ensure that  
23 whatever result happens here, presses of all the  
24 arguments available, presses them to the best and  
25 fullest extent of their abilities, including the

1 talents of their counsel, and that there will be no  
2 stone left unturned.

3 And indeed, to date, we've seen no divide  
4 between the State and Narragansett. They present the  
5 identical issues, argued in the identical way. And to  
6 the case that Mr. Petros cited out of the Fifth  
7 Circuit, Gulf States Utilities versus Alabama Power,  
8 824 F.2d 1465, that decision has been criticized by the  
9 Fifth Circuit in a case that we cited to the Court.  
10 That's the Cajun Electric case at 940 F.2d, 117.

11 And there the panel deciding Cajun Electric four  
12 years later took issue with the prior panel's decision  
13 that there was grounds to allow the Public Utility  
14 Commission there to intervene. The Court says that  
15 (Reading:) Were we not bound by that decision, because  
16 the subsequent panel may not overrule a decision of an  
17 earlier panel, we might decide differently. And I'm  
18 quoting from around page 120, your Honor.

19 The Court, Fifth Circuit in Cajun Electric goes  
20 on to decide that intervention is not warranted because  
21 there is no inadequacy of representation of the  
22 interests at stake. The state's utility commission  
23 advanced nothing separate and distinct that couldn't be  
24 protected by the litigant involved.

25 So on the inadequacy element of Rule 24,

1 intervention was denied. And the same result obtains  
2 here. And in fact, your Honor, Judge Lagueux,  
3 hopefully I'm pronouncing that correctly --

4 THE COURT: Right up there.

5 MR. IRVIN: So I understand, your Honor.

6 -- had decided a case that is very similar to  
7 this. And we cited the First Circuit's disposition  
8 affirming him, but if you go through his decision,  
9 which I believe is reported at 173 FRD 17, he addresses  
10 whether ratepayers and users should intervene in a  
11 proceeding that involved utilities in New Hampshire  
12 suing their utility commission. And he found that the  
13 interest of the ratepayers was no different than a  
14 generalized interest in cheaper electricity, which we  
15 all share.

16 THE COURT: That was a citizens group, though,  
17 not the State. So there's a difference, isn't there?

18 MR. IRVIN: Some of the intervenors were  
19 citizens groups, some were large scale users. It also  
20 included the City of Manchester and other Governmental  
21 entities. So he denied their intervention because he  
22 found, among other reasons, that the defendant in that  
23 case, the Public Service Commission of New Hampshire  
24 was adequate to represent the interests of those  
25 parties.

1           So it doesn't line up squarely with the, you  
2 know, the roster of players here and their assigned  
3 positions in the litigation, but, effectively, it is  
4 four square with this case because the party who  
5 brought this lawsuit, Narragansett, is fully capable  
6 and fully incentivized to defend the interest of  
7 ratepayers not to take a dive and incur some obligation  
8 of Constellation that would deprive the ratepayers of  
9 only paying prudently incurred reasonable costs.

10           And there is nothing that you can point to in  
11 either Judge Lagueux's disposition or the First  
12 Circuit's confirmation of that that distinguishes this  
13 case that allows intervention. The interest that the  
14 State is required to have --

15           THE COURT: Isn't one of the differences there,  
16 correct me if I'm wrong, but in that case, the position  
17 of the PUC in New Hampshire was really different than  
18 what the position of the PUC would be in this case as a  
19 result of this statute.

20           So in kind of an odd way, this statute, which is  
21 arguably an abdication of authority to conduct  
22 oversight of rate increases resulting from these types  
23 of contracts, that heightens the interest of the State,  
24 the PUC, the Division of Public Utilities in this  
25 action because, I mean, the case you're referring to

1       resulted from, I think, an adversarial relationship  
2       between the New Hampshire PUC and the New Hampshire --  
3       the public service company in New Hampshire over  
4       Seabrook.

5               So they were a completely adverse position and  
6       the PUC was aggressively representing the ratepayers by  
7       prohibiting the Public Service Corporation or company  
8       from passing through the costs associated with  
9       Seabrook.

10              So I think the context of that case is very  
11       different from what the context, arguably, is in this  
12       case.

13              MR. IRVIN:  If I may, your Honor, I'm not  
14       certain that is -- it is different.  I agree with you.  
15       And in the chronology of the regulatory reforms that  
16       have occurred in the electrical energy industry, the  
17       Patch case, the New Hampshire case occurred at the  
18       inception of a lot of these changes.  And in that case,  
19       the public utility commission in New Hampshire was  
20       trying to implement a plan that would effectuate and  
21       their conceptualization then, essentially, what we have  
22       today in Rhode Island and many other states, which is  
23       the local utility company would have its business  
24       restructured so that it would only be in the business  
25       of distributing power to consumers such as you or

1 myself. And we, as consumers, would have the right to  
2 pick our supplier of the commodity that is energy.

3 And the plan that is at issue in the public  
4 service in New Hampshire case would basically have  
5 deprived public service of New Hampshire of the  
6 benefits that it had struck in its reorganization  
7 proceeding dealing with the recovery of all the costs  
8 associated with the nuclear facility that they  
9 constructed up there.

10 And so what they were concerned with, the  
11 utilities in New Hampshire were concerned that the plan  
12 that the public service commission of New Hampshire was  
13 promulgating would not allow them to recover all of  
14 their costs incurred in the wholesale market, and the  
15 lawsuit was brought to force the utility commission to  
16 respect that.

17 Here we sort of have the flip side of that coin.  
18 Here Narragansett is one of these wholesale contracts  
19 with Constellation. There is a right, we believe  
20 clear, to have an adjustment in the price paid when  
21 there's an intervening regulatory change such as the  
22 one at hand, and Narragansett has rights to pass  
23 through any prudently incurred costs to ratepayers.  
24 And so the identity of interest or the community of  
25 interest between the public service commission and

1 Narragansett Electric is full fold, is fully aligned  
2 just as it was between the applicant intervenors and  
3 Public Service of New Hampshire v. Patch, and it was  
4 that identity or that community of interest that led  
5 the court to deny intervention, finding that there was  
6 no need to have somebody basically reiterating the same  
7 points. There was no nonfeasance, no palpable conflict  
8 or other divide between the Public Service Commission,  
9 who was defending that case, and the ratepayers as  
10 there is none here between Narragansett Electric who,  
11 your Honor, they filed suit. They proved themselves an  
12 able litigant. They know how to press their interests,  
13 and they are going to fully ensure that they do not do  
14 anything that's going to get them cross-wise with the  
15 ratepayers. They do not have -- the statutory language  
16 notwithstanding, I would be surprised that any court  
17 would affirm they have the right to pass through any  
18 costs whatsoever.

19 THE COURT: Let me ask you another practical  
20 question, which is, let's say I denied the motion to  
21 intervene. Wouldn't the State have standing to bring  
22 its own declaratory judgment action under this  
23 settlement agreement separate from this action to  
24 assert the waiver -- not waiver but whatever VIII(A),  
25 the title of that section is, against Constellation,

1 and so we'd effectively be litigating, you know, the  
2 same issue just in two separate cases. I might end up  
3 consolidating those cases anyway.

4 MR. IRVIN: If there was a cognizable case for  
5 the State to bring, I think our preference would be to  
6 do it all in one forum. But your Honor, I don't think  
7 that there is a cognizable case for the State to bring.  
8 And I do believe that it is appropriate and necessary  
9 in a Rule 24 motion to consider whether the claim, the  
10 putative claim by the intervenor applicant is  
11 cognizable, because, first of all, the Rule requires  
12 that they have a claim or defense that would be  
13 impacted. Right? So they have to have something that  
14 the law recognizes that could be affected.

15 Second of all, it's incumbent on every Federal  
16 Court to review its subject matter jurisdiction any  
17 time it takes action. So that question is before the  
18 Court every time you take the bench.

19 I don't think the State has standing to bring a  
20 suit against us under the settlement agreement, because  
21 such a suit would be nothing more than a general  
22 interest in compliance. The fact that the State is  
23 specifically mentioned in that settlement agreement  
24 does not change the outcome of that. It's important to  
25 remember that Constellation did not sign that

1 settlement agreement. That agreement is binding as a  
2 contractual matter amongst its parties, but it's  
3 binding on non-parties only so far as FERC ordered it.  
4 And FERC says nothing in its orders about binding  
5 Constellation in Section VIII(A). And you know,  
6 importantly, your Honor, the FERC orders reviewing the  
7 settlement agreement say nothing about that section at  
8 all.

9 In addition, your Honor, the settlement  
10 agreement by its express terms says that commenting on  
11 or opposing the settlement agreement shall not be  
12 deemed to be a waiver or in any way conflict with  
13 existing contracts. That's the provision in the  
14 settlement agreement that expressly applies to settling  
15 parties. And if it works for settling parties, it most  
16 certainly can't work to a different outcome for  
17 non-settling parties. So the State can show no injury,  
18 in fact, from the settlement agreement. And in fact,  
19 when you press the State's counsel about their injury  
20 presently, other than they were in this proceeding and  
21 they had an understanding about what Constellation's  
22 position was and now it turns out that maybe their  
23 understanding was different, they haven't identified  
24 any concrete --

25 THE COURT: Slow down a little.

1           MR. IRVIN: I get excited, your Honor, and start  
2 talking too fast. I apologize.

3           They haven't identified any concrete specific  
4 injury, in fact, that has occurred yet. And to the  
5 extent we resolve our differences with Narragansett and  
6 Narragansett has an obligation to us, then the State  
7 ratepayers face possibly having to pay for some  
8 increase in costs, but there is the rights of review  
9 that exist there and the rights to shape that  
10 pass-through as the State deems appropriate.

11          THE COURT: But if they -- you're saying there's  
12 no injury in fact, so the State has to wait until the  
13 proceeding is complete and the costs are passed  
14 through, and then the rates are imposed upon the  
15 ratepayers. Is that when there's an injury?

16          MR. IRVIN: The State's interests are in what it  
17 allows Narragansett to charge ratepayers, so, yes, that  
18 would be the injury. But the State has another avenue  
19 available to itself. It can go to FERC, and it can  
20 seek to have FERC clarify that the settlement agreement  
21 does what it says it claims it does, or it could ask  
22 for additional relief trying to reform our contracts  
23 explicitly. And it is not without rights to address  
24 whatever concerns it has about the FERC settlement  
25 agreement. It can go back and petition the agency that

1 conceived that settlement agreement. This is when  
2 you're talking about our rights under the PPAs, you  
3 know, it's undisputed the State doesn't have any  
4 interest there. I think it's pretty commonly  
5 understood as a matter of contract law as well as a  
6 matter of wholesale energy contracts that contracts  
7 between a wholesale supplier and a utility provide,  
8 because they don't otherwise specifically provide, then  
9 ratepayers are only incidental beneficiaries, and under  
10 contract law incidental beneficiaries don't have rights  
11 to sue for breach or enforcement.

12 Likewise, under the settlement agreement, if the  
13 State believes it didn't get what it wanted or needs  
14 additional relief, the authority to petition for that  
15 is the Federal Regulatory Energy Commission. It's the  
16 body that has exclusive authority over how the  
17 wholesale markets work in New England and throughout  
18 the country. And contentions that the filed rate  
19 doctrine is not implicated here are just not -- they  
20 strain credulity. These case are all about the filed  
21 rate doctrine. Our contracts, we call them contracts  
22 but they're protected under the filed rate doctrine.  
23 Our rights under those contracts, Narragansett's rights  
24 under those contracts cannot be waived, cannot be  
25 changed or abrogated in the absence of mutual consent

1 unless FERC grants that relief.

2 THE COURT: But I think Mr. Petros is saying  
3 that, he obviously disagrees with you, but that that is  
4 an argument that is more appropriate for the March 5th  
5 argument on the motion to dismiss. It's premature in  
6 this context.

7 MR. IRVIN: As it concerns Narragansett, I agree  
8 it's premature. As it concerns the State, Rule 24  
9 requires that the State have an interest that is  
10 cognizable that will be impacted by this proceeding.  
11 And I don't think that Rule 24 contemplates that the  
12 Court would allow somebody to intervene just to then a  
13 couple of weeks later dismiss their case for lack of  
14 subject matter jurisdiction or for other cause under  
15 12(b). That would seem a form over substance result.

16 THE COURT: I guess what you're saying, too, is  
17 that you believe the filed rate doctrine applies to  
18 both Narragansett and the State, but it applies  
19 somewhat differently to each of them, because it's just  
20 the other side of the argument you just made, because  
21 the State is not -- I'm sorry, Constellation is not a  
22 party to this settlement agreement, and because the  
23 State is only an incidental beneficiary, they don't  
24 even have the standing of a party to a contract that  
25 would allow them to be in this case as a contract case.

1 So, really, their remedy is in FERC. So I guess in a  
2 way you're saying that it's just enhanced when it comes  
3 to the State.

4 MR. IRVIN: The requirements of standing before  
5 an Article III court are more narrow, more exacting  
6 than what FERC requires. FERC has recognized that a  
7 Public Utility Commission, for example, can, before  
8 FERC under Section 206 of the Federal Power Act,  
9 challenge wholesale supply agreements between a utility  
10 that that public utility commission regulates and a  
11 third-party supplier.

12 So to the extent that the State has a claim or a  
13 complaint that the settlement agreement does or because  
14 of the settlement agreement there ought to be a bar of  
15 Constellation's rights under its PPAs, the State is  
16 fully empowered to bring that complaint to FERC. FERC  
17 has explicit process for that. And that's the  
18 appropriate venue for this, because when it comes to,  
19 you know, denying us our right to the equitable  
20 adjustment as a matter of that settlement agreement  
21 changes our rates, that implicates the filed rate  
22 doctrine and that gets us to this Mobil/Sierra line of  
23 cases that we've brought to the Court's attention.  
24 Those cases require there be particularized findings  
25 that our contract so adversely impacts the public

1 interest that changes are warranted. Only FERC is  
2 authorized to make those findings and to order that  
3 kind of relief. So if the State has that kind of issue  
4 here, then the FERC is the place to go.

5 THE COURT: So that means this issue will be  
6 litigated in two different forums, right? It will be  
7 in the Federal District Court, and it will be going on  
8 at FERC?

9 MR. IRVIN: Well, I guess my hope would be that  
10 there would be an arbitration between Constellation and  
11 Narragansett about the amount of the adjustment.

12 THE COURT: So maybe there will be three forums,  
13 if you get your way.

14 MR. IRVIN: I'm not looking to proliferate  
15 litigation across the different venues, but, you know,  
16 I suppose this Court could stay its hand pending some  
17 kind of outcome elsewhere, but in the case of the  
18 arbitration, your Honor, we think the issue is properly  
19 referred to the arbitration panel. Conditions  
20 precedent to relief under disputes directed to  
21 arbitration is for an arbitration panel to decide, and  
22 under the Federal Arbitration Act your function is to  
23 decide whether this is a dispute that the parties  
24 committed to arbitration or not. And when you  
25 determine that question, then your role is done at that

1 stage, then the arbitration panel takes over and it  
2 decides the dispute. It decides whether on the merits  
3 because of Constellation's conduct, because of the way  
4 the structures were changed or not there should be an  
5 adjustment, and it should be in whatever dollar amount  
6 the panel may decide.

7 You know, it's also, you know, we've been  
8 labeled as claiming \$150 million, your Honor. We're  
9 not asking for that. The costs here are roughly \$150  
10 million increase, but we're looking for an adjustment.  
11 We're looking for an apportionment of that expense  
12 between the buyer and the seller. And that  
13 apportionment, to my way of thinking, is appropriately  
14 shared because the changes that FERC has put forward in  
15 consequence of the marketplace here are to increase  
16 reliability and to make sure we don't have blackouts,  
17 make sure that we have functioning marketplaces and  
18 that's for the benefit of end-users, for consumers.

19 And so there is some responsibility that  
20 end-users bear for the changes that have been made.

21 THE COURT: Some mention was made that you're  
22 filing an action. Are you filing an action in this  
23 Court?

24 MR. IRVIN: Not to my knowledge. Yes. I heard  
25 that reference too, and if I forgot to do some kind of

1 litigation trick, then I apologize. But, no. If the  
2 reference was intended to refer to the fact that we  
3 communicated with Narragansett in the summer of 2006 a  
4 request to discuss an equitable adjustment, then we  
5 followed that up with a letter formally invoking our  
6 rights, and then had some discussions and then this  
7 lawsuit came forth, we certainly did send a letter. We  
8 have not initiated any other action in court or at FERC  
9 yet about this proceeding or about this dispute.

10 THE COURT: That was my next question. Do you  
11 have the right, do you think you have the right to  
12 initiate an action at FERC for the adjustment that you  
13 seek?

14 MR. IRVIN: That's not clear that we have that  
15 right because that, you know, as I understand, as I  
16 view our claim, our claim is one for money damages,  
17 basically, for an adjustment that economically and  
18 fairly apportions these increased costs. Perhaps we  
19 could petition FERC for that relief, but that's  
20 typically the type of contract dispute that the  
21 commission prefers the courts to handle.

22 So if we're in the realm of that bilateral  
23 contract dispute, which we think should be an  
24 arbitration, it's not clear to me that we have rights  
25 as a petitioner to FERC. I contrast that to what I see

1 the State or Narragansett doing, which would be asking  
2 FERC on public policy grounds in conformance with this  
3 Mobile-Sierra doctrine to reform our contract so we  
4 cannot get any adjustment so that we do not have our  
5 rights in this provision, this market change rule and  
6 each of the four PPAs. Those are different. If it was  
7 simply a matter of suing to collect money damages, the  
8 courts have concurrent jurisdiction with FERC, and  
9 generally, FERC, under a line of cases called Arkla v.  
10 Hall, which also shares a Supreme Court case, has an  
11 analysis of when FERC will exercise or assert its  
12 primary jurisdiction, and in money damages cases, FERC  
13 typically does not. But cases seeking to reform  
14 contracts, seeking to reform a settlement agreement,  
15 for example, that's solely for FERC, because that's a  
16 change in the filed rate.

17 THE COURT: Okay. Have you covered everything?

18 MR. IRVIN: I think I have, unless any of my  
19 colleagues -- you know, I want to just conclude with  
20 coming back to this question of is it premature to deal  
21 with the merits of the State's case, and I do not think  
22 it is. I think Rule 24 requires that. And the State  
23 in its remarks this morning fleshed out a little bit  
24 more about this waiver claim than we've heard today.

25 The State made specific reference to reports

1 filed by the presiding administrative law judge over  
2 the settlement proceedings that spawned this settlement  
3 agreement and was Administrative Law Judge Brenner.  
4 The State points to reports that he made, and the way  
5 the process works at FERC is the commission empowers a  
6 judge to preside over proceedings and then, as I think  
7 is customary for this court, he reports back to the  
8 commission saying, you know, we're making progress,  
9 please let me have more time, or, you know, we're at  
10 loggerheads, call it quits, it's yours to decide. And  
11 he issued these periodic reports along the way. Their  
12 waiver claim as it appears now this morning rests on  
13 two things. One report in January saying Constellation  
14 opposes the settlement, and another report in April,  
15 after the settlement agreement was signed by the State,  
16 saying ultimately Constellation withdrew.

17 Well, it's not clear to me how you can have  
18 detrimental reliance on a report that occurs after you  
19 signed. In any event, to me what's missing from their  
20 allegation is where were their direct communication  
21 with Constellation? Why didn't they nail this down  
22 with us? We were not a party to this settlement  
23 agreement, because we did not think that it made sense.  
24 We had our contractual rights to protect ourselves on  
25 this adjustment, and nobody came to us and said we want

1 you to waive those. And in fact, there's no  
2 consideration for Constellation to do that. They try  
3 and hint at it by talking about this merger at the time  
4 with Florida Power that was considered, but that has no  
5 consideration for Constellation, that merger never went  
6 forward. You know, for Constellation to give up on its  
7 rights to some portion, to recover some portion of a  
8 \$150 million, there's no explanation of why we would do  
9 that. And there's no explanation because this was  
10 never addressed squarely. So the issue of does this  
11 arcane language in the settlement agreement, which is  
12 never expressly addressed by FERC, affect something  
13 that takes away contractual rights? You know, that's  
14 not a question to be brought before this court. That's  
15 a question to be brought before FERC. And if the State  
16 can't bring that case in this proceeding or otherwise  
17 in a court, then there's no cause for intervention,  
18 your Honor.

19 And so we would ask the Court to deny the  
20 intervention, and we look forward to coming back and  
21 meeting with you on the 5th.

22 THE COURT: Thank you. All right. Either  
23 Mr. Wold or Mr. Petros want to reply to any points made  
24 here?

25 MR. PETROS: Just very briefly if I may, your

1 Honor. The Court's been very indulgent. I won't take  
2 more if its time.

3 Judge, there was a football game this last  
4 Sunday that was played. And if you were like me, you  
5 might have seen the TV a few times between 8:00 in the  
6 morning and 6:30, there were about 12 hours of endless  
7 pregame reports going on ESPN and CBS and all the rest  
8 of the networks. And you kept feeling like can we just  
9 get to the game and play the game.

10 I feel a little bit like that this morning. I  
11 want March 5th to come. Can we get to the motion to  
12 dismiss and argue those issues there where I think they  
13 really belong.

14 I would just say, your Honor, that I don't think  
15 that the State has to prove that it's going to win the  
16 case in order to intervene. I think the standard is  
17 very different on a motion to intervene.

18 There were a number of substantive matters  
19 discussed by Mr. Irvin that really go to the motion to  
20 dismiss. I'm going to repress my natural instinct to  
21 respond to them with one very brief exception.

22 Constellation again contends somehow that because it  
23 didn't sign the settlement agreement it, in some murky  
24 way that's not clear to me yet, isn't bound by Section  
25 VIII(A). I just want the Court to know that we

1       couldn't disagree more strongly with any such  
2       assertion, and on March 5th, we'll demonstrate why  
3       that's wrong.

4               Thank you, your Honor.

5               THE COURT: Mr. Wold?

6               MR. WOLD: Nothing further, your Honor.

7               THE COURT: All right. I understand what  
8       Mr. Petros is saying. We're sort of dancing around the  
9       issues that are in the motion to dismiss. And to some  
10      degree, I'm a little bit hamstrung in looking at the  
11      motion to intervene, because I've only reviewed the  
12      briefs on the motion to intervene, but there's a lot of  
13      references to the more substantive arguments that are  
14      made in the motion to dismiss papers, and I haven't  
15      really fully reviewed all those papers.

16              I suppose one solution to that problem is to  
17      simply allow the State to participate as an amicus for  
18      the interim and then to, perhaps, wrap up the motion to  
19      intervene into the motion to dismiss and dispose of it  
20      all as one kind of complete package, deal with  
21      everything that's before me at that time, put it all  
22      together, but not deprive the State of any of its  
23      ability to advocate in the context of that motion so  
24      that I don't think there's really any loss to the  
25      public utilities division or the attorney general. Do

1 any of you have any thoughts about that?

2 MR. WOLD: Your Honor, we have no problem with  
3 that. We believe that the Court's schedule, as it's  
4 already been set forth, will allow us to file our  
5 response papers in connection with the motion to  
6 dismiss. And then at the March 5th hearing if the  
7 Court wants to reserve judgment on the intervention  
8 motion and in the interim we can have amicus status,  
9 that is acceptable to the State. We just want to make  
10 it clear that we do believe that we're more than just  
11 an amicus in this case. We believe we're a  
12 full-fledged intervenor with substantive rights that we  
13 wish to pursue on behalf of the State.

14 THE COURT: Any position on that?

15 MR. PETROS: Your Honor, again, we contend the  
16 State's met its burden for intervention, and far more  
17 than that. In fact, really has direct party status, if  
18 anything. Obviously, I think it's important that the  
19 State participate in the next phase.

20 If the Court grants the motion to intervene, all  
21 of the issues that Mr. Irvin argued today will be  
22 argued on the motion to dismiss and the Court could  
23 dismiss the claim after permitting intervention, but if  
24 the Court is convinced by Constellation arguments,  
25 which I don't think it will be, so I think either

1 method would deal with the issues.

2 MR. IRVIN: Your Honor, Constellation has no  
3 objection to the process you suggested, that is to  
4 allow the State to participate in the motion to dismiss  
5 proceedings on sort of a conditional basis or as an  
6 amicus. I think that makes sense. As I said in my  
7 remarks, I think that Rule 24 would contemplate the  
8 Court granting an intervention only then to deny the  
9 putative complaint. I think the two are related and  
10 consequently the process you suggest is fine by  
11 Constellation.

12 THE COURT: All right. I won't say for certain  
13 that that's what I'm going to do, but I may well, and  
14 for the reasons that I outlined.

15 In any event, I'll take it under advisement.  
16 I'll give you a read one way or the other on that last  
17 point fairly shortly, and then I'll see you on March  
18 5th. Okay. Thank you.

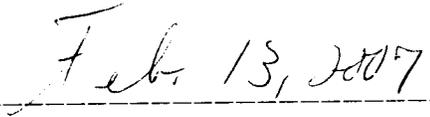
19 (Court concluded at 10:55 a.m.)  
20  
21  
22  
23  
24  
25

C E R T I F I C A T I O N

I, Anne M. Clayton, RPR, do hereby certify that the foregoing pages are a true and accurate transcription of my stenographic notes in the above-entitled case.



\_\_\_\_\_  
Anne M. Clayton, RPR



\_\_\_\_\_  
Date