



State of Rhode Island and Providence Plantations

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*Patrick C. Lynch, Attorney General*

March 20, 2009

*Via Electronic Filing and Regular Mail*

Luly Massaro, Clerk  
Public Utilities Commission  
89 Jefferson Blvd.  
Warwick, RI 02888

Re: National Grid's Natural Gas Portfolio Management Plan  
Docket No. 4038

Dear Ms. Massaro:

Enclosed for filing on behalf of the Division of Public Utilities and Carriers, please find an original and nine copies of the Direct Testimony of Bruce R. Oliver in connection with the above-captioned proceeding.

Due to the proprietary nature of limited portions of the testimony, I am only filing the public version. The non-redacted, non-public version will be hand delivered and filed under seal.

Thank you for your attention to this matter.

Very truly yours,

Paul Roberti  
Assistant Attorney General  
Chief, Regulatory Unit

Enclosures

cc: Service List  
Thomas F. Ahern, Administrator  
Steve Scialabba, Chief Accountant

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

**IN THE MATTER OF**

**National Grid's Natural Gas  
Portfolio Management Plan**

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**Docket No. 4038**

**DIRECT TESTIMONY OF WITNESS  
BRUCE R. OLIVER**

**(REDACTED VERSION)**

On Behalf of

**The Division of Public Utilities and Carriers**

*March 20, 2009*

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**I. INTRODUCTION**

1

2

3 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS FOR THE RECORD.**

4 A. My name is Bruce R. Oliver. My business address is 7103 Laketree Drive, Fairfax Station,  
5 Virginia, 22039.

6

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

8 A. I am employed by Revilo Hill Associates, Inc., and serve as President of the firm. I manage  
9 the firm's business and consulting activities, and I direct its preparation and presentation of  
10 economic, utility planning, and policy analyses for our clients.

11

12 **Q. ON WHOSE BEHALF DO YOU APPEAR IN THIS PROCEEDING?**

13 A. My testimony in this proceeding is presented on behalf of the Division of Public Utilities and  
14 Carriers (hereinafter "the Division").

15

16 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

17 A. This testimony addresses issues relating to the proposal of National Grid hereinafter "NGrid"  
18 or "the Company") for the implementation of its proposed Natural Gas Portfolio  
19 Management Plan ("NGPMP"). As part of this testimony I will review the key elements of

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1 the Company's proposal and discuss representations made regarding the proposed plan, its  
2 operation, and its benefits to ratepayers that are presented in support of that proposal by  
3 National Grid witnesses McCauley, Arangio, and Beland.

4  
5 **II. DISCUSSION OF ISSUES**

6  
7 **Q. HAVE YOU REVIEWED THE DETAILS OF THE NATURAL GAS PORTFOLIO**  
8 **MANAGEMENT PLAN THAT IS ATTACHED TO THE DIRECT TESTIMONY OF**  
9 **NGRID WITNESS MCCAULEY AS EXHIBIT SAM-1?**

10 A. Yes, I have.

11  
12 **Q. DO YOU SUPPORT THE COMMISSION'S ADOPTION OF THE NGPMP AS**  
13 **PRESENTED IN EXHIBIT SAM-1?**

14 A. In the context of the considerations set forth in the remainder of this testimony, I do with two  
15 exceptions.

16  
17 **Q. WHAT ARE THE TWO EXCEPTIONS THAT YOU NOTE ABOVE?**

18 A. First, I recommend that paragraph II.C. should be deleted. In my assessment, the suggestion  
19 that operation of the NGPMP in a manner that parallels the current practices embedded in the  
20 Company's previous asset management contracts does not necessarily provide either (1) a  
21 "measure of the Company's performance under the Plan" or (2) a clear indication of the

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1           reasonableness of “benefits to customers” under the Plan. The actual operating parameters  
2           for the Plan are set forth in subsequent sections of the Plan, and the general representation  
3           that “the Company will operate the plan in a way that parallels the current practices  
4           embedded in its previous asset management contracts with its outsource suppliers,” may be  
5           appropriate in testimony, but is unnecessary to the filed language of the Plan. Furthermore, I  
6           find the listing of the names of previous asset managers at the end of that paragraph  
7           unnecessary.

8                        Second, I recommend that the Quarterly and Annual reporting requirements set forth  
9           in Section VIII should be expanded to provide greater itemization of costs incurred on a  
10          transaction by transaction basis. Quarterly and Annual reports should separately show  
11          commodity costs, costs of capacity, and other transaction costs (by type). Annual reporting  
12          should also reflect assignments and allocations of Service Company costs associated with  
13          asset management activities that are assigned or allocated to National Grid’s Rhode Island  
14          gas system operations.

15  
16   **Q.    FROM A RATEPAYER PERSPECTIVE, WHAT ARE THE KEY ELEMENTS OF**  
17   **THE COMPANY’S NATURAL GAS PORTFOLIO MANAGEMENT PLAN?**

18   **A.    Key elements of the Company’s NGPMP proposal include:**

- 19  
20           ➤    In-sourced management of natural gas assets by National Grid, as opposed to  
21           reliance on third-party asset managers;

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- Replacement of a fixed annual benefit determined through competitive bidding with a minimum annual credit and a sharing of net asset management revenue achieved over and above that minimum benefit level which provides the potential for substantial additional benefit for firm gas sales service customers;
  
- Enhanced reporting of information relating to the asset management transactions;
  
- Compatibility with the Company's existing Gas Procurement Incentive Program.

**Q. SHOULD THE COMMISSION FIND THE COMPANY'S PROPOSAL TO SELF-MANAGE ITS GAS ASSETS A BENEFIT TO RATEPAYERS?**

A. NGrid's self-management of its gas assets will be beneficial if the Company's management of the assets :

- (1) Renders benefits that meet or exceed the ratepayer benefits that would be expected from a reasonably structured third-party asset management arrangement;

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- (2) Sufficiently documents the transactions to provide for transparency; and
  
- (3) Does not impose unreasonable administrative cost on NGrid's customers.

Some measure of additional benefit may also be attributed to:

- (a) The Company retaining control of its gas assets; and
  
- (b) The Company developing greater in-house expertise relating to the management of natural gas assets for its Rhode Island operations.

Thus, with the exercise of reasonable oversight by the Commission and the Division, the Company's plan appears to offer the potential for increased ratepayer benefit without large downside risk.

**Q. DO YOU HAVE ANY CONCERNS REGARDING THE NGPMP THAT NATIONAL GRID PROPOSES?**

A. Although I believe that on balance the NGPMP will benefit firm gas sales service customers in Rhode Island, there are some elements of the plan over which the Commission and the Division will need to exercise some additional oversight if this plan is to continue to serve

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1 the interests of National Grid's Rhode Island customers over time. Key areas in which the  
2 exercise of such oversight will be important include:

3  
4 ➤ The on-going appropriateness of the level of the guaranteed minimum credit  
5 provided to ratepayers;

6  
7 ➤ The transparency of asset value determinations; and

8  
9 ➤ The reasonableness and appropriateness of costs charged to asset  
10 management transactions.

11  
12 **Q. WHY DOES THE LEVEL OF THE GUARANTEED MINIMUM ANNUAL CREDIT**  
13 **WARRANT PERIODIC REVIEW?**

14 A. Assets values are not static over time. In today's natural gas markets, the value of natural gas  
15 assets such as interstate pipeline capacity and storage capacity vary with market conditions.  
16 Moreover, expected levels of net revenue to be derived through management of any given  
17 asset may fluctuate with changes in factors that are beyond the Company's direct influence  
18 and control. Competitive bidding for the selection of a third-party asset manager generally  
19 provides a market-based indication of the expected market value of the Company's assets at a  
20 point in time. However, under the Company's proposal for self-management of natural gas  
21 assets that market-based assessment of value would be lost.

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1           A well-structured asset management incentive should only compensate the Company  
2           for the added benefits it achieves. Where the Company's actions clearly enhance the revenue  
3           derived through its management of natural gas assets, the provision of added compensation  
4           to the Company can be justifiable. But NGrid should not be penalized if factors beyond the  
5           Company's control make a guaranteed benefit level unachievable. On the other hand, if the  
6           market value of the Company's gas assets increases due to factors beyond the Company's  
7           control, no additional compensation to the Company in the form of incentives is necessary to  
8           achieve the increase in asset management revenue that results. Thus, in the absence of a  
9           competitive bidding process to establish guaranteed benefit levels, periodic review of the  
10          Company's actual experience by the Commission may be necessary to provide reasonable  
11          assurance that guaranteed benefit levels are properly established.

12  
13 **Q. HAS NGRID PROVIDED ANY EVIDENCE OF THE MAGNITUDE OF RECENT**  
14 **FLUCTUATIONS IN NATURAL GAS ASSET VALUES?**

15 **A.** Yes. As noted in the Direct Testimony of NGrid witness McCauley at page 7, the guaranteed  
16 benefit from the Company's current supplier of third-party asset management services for the  
17 twelve months ending March 31, 2009 is \$[REDACTED]. For the immediately preceding  
18 twelve-month period, the guaranteed benefit for Rhode Island customers was  
19 \$[REDACTED]. These figures reflected a marked change in the market value of the  
20 Company's natural gas assets.

21

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1 **Q. IN THE CONTEXT OF THE FOREGOING DISCUSSION, IS THE \$1.0 MILLION**  
2 **GUARANTEED MINIMUM ANNUAL BENEFIT THAT THE COMPANY OFFERS**  
3 **AS PART OF ITS NGPMP PROPOSAL REASONABLE?**

4 A. I believe it is. Pricing in energy markets has fallen precipitously over the past eight months  
5 and that has created substantial uncertainty regarding the expected value of natural gas assets.  
6 Thus, rather than using a higher minimum guarantee that may prove unachievable, NGrid's  
7 proposal, which uses a lower (yet positive) minimum guarantee coupled with 80% of  
8 incremental revenue accruing to the benefit of firm gas sales service customers, represents a  
9 reasonable and prudent alternative. As indicated by the data presented in Exhibit SAM-2,  
10 attached to the Direct Testimony of NGrid witness McCauley, the approach the Company  
11 proposes limits the Company's exposure if energy markets experience further decline while  
12 providing Rhode Island consumers **reasonably comparable**, if not significantly improved  
13 benefits within most of the range of what would appear to be likely potential outcomes.

14 .

15 **Q. WHY IS THE TRANSPARENCY OF ASSET MANAGEMENT TRANSACTIONS**  
16 **AND TRANSPARENCY WITH RESPECT TO THE COSTS INCURRED TO**  
17 **CONDUCT TRANSACTIONS A POTENTIAL AREA OF CONCERN?**

18 A. In past periods competitive bidding by potential third-party asset managers provided a  
19 market-based measure of the value that asset management could provide for Rhode Island  
20 consumers. Once the competitive bid was awarded and the annual benefit established,  
21 neither National Grid nor the Commission needed to be concerned regarding the details of

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1 the actual costs that the third-party asset manager incurred as long as it continued to meet its  
2 obligations to National Grid with respect to the management of Rhode Island assets. With a  
3 shift to in-house management of the Company's gas assets, that market-based determination  
4 of value is lost, and the Commission is left with few, if any, benchmarks against which to  
5 measure the reasonableness of the level of net asset management revenue that is generated  
6 and the reasonableness of the costs that are incurred, allocated and assigned to the  
7 Company's Rhode Island operations to achieve reported net asset management revenue. In  
8 this context, an increased burden arises for the Company to report and the Commission and  
9 Division to monitor the details of both directly incurred costs and allocations and/or  
10 assignments of Service Company charges<sup>1</sup> related to asset management activities. Thus, a  
11 substantial burden rests with the Company to fully disclose and document the types of costs  
12 and amount of costs associated with individual transactions, as well as the overall costs of  
13 the asset management function. Since external measures of the reasonableness of such costs  
14 may be difficult to obtain, such documentation will be necessary for the Commission and the  
15 Division to gain confidence that the costs charged to individual transactions and the costs  
16 billed to the Company's Rhode Island gas system are reasonable and appropriate.

17  
18 **Q. NATIONAL GRID WITNESS MCCAULEY SUGGESTS THAT THE NGPMP WILL**  
19 **PROVIDE GREATER TRANSPARENCY WITH RESPECT TO THE EXECUTION**

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<sup>1</sup> It must be understood that the Company's management of natural gas assets will be performed by persons who are direct employees of National Grid's Service Company, not direct employees of the Company's Rhode Island gas utility. Moreover, it can be expected that some or all of the persons engaged in such activities on behalf of National Grid's Rhode Island gas system will be performing similar activities for other National Grid subsidiaries.

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1           **OF OPTIMIZATION TRANSACTIONS AND THE REALIZED VALUE OF THE**  
2           **OPTIMIZED PORTFOLIO. DO YOU AGREE?**

3    A.    Only in part. Witness McCauley is correct that the present outsourcing arrangement provides  
4           no detail regarding the actual transactions that the asset manager undertakes or the costs that  
5           the third-party asset manager incurs. But under the current outsourced asset management  
6           arrangement, the need for such information is negated by transparency of the up-front  
7           competitive determination of asset management values.

8                    Under the Company's proposal in this proceeding, the Commission and the Division  
9           should have access to greater detail regarding the actions taken by the Company to enhance  
10          the value of its Rhode Island portfolio. However, increased data does not necessarily equal  
11          increased transparency. Without the benefit of either a history of comparable data for past  
12          transactions or system of external benchmarks against which to measure the performance of  
13          such in-sourced activities, the Commission and the Division may lack adequate basis for  
14          assessing the Company's performance. Thus, it will be incumbent upon National Grid to  
15          assist the Commission and the Division in their development of understanding and comfort  
16          with the levels of costs and benefits actually experienced.

17  
18    **Q.    HOW IMPORTANT TO RATEPAYERS ARE THE BENEFITS ASSOCIATED**  
19          **WITH IN-HOUSE, AS OPPOSED TO THIRD-PARTY, MANAGEMENT OF THE**  
20          **COMPANY'S NATURAL GAS ASSETS?**

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1 A. In these difficult financial times, the potential that a third-party may encounter financial  
2 problems that may encumber its ability to provide contracted asset management services has  
3 clearly increased. As NGrid witness McCauley explains, such considerations can become  
4 more critical if a supplier of asset management services should file for bankruptcy. Over the  
5 past several months, a number of potential suppliers of asset management services have been  
6 adversely affected by the credit crunch and related financial market issues, and some have  
7 either changed ownership or left the business. Although many of the concerns regarding  
8 third-party suppliers could potentially be addressed through well-drafted contract provisions  
9 that ensure National Grid's access to its assets in a bankruptcy situation, the addition of  
10 contract provisions could reduce the levels of benefit that asset managers offer.

11 Witness McCauley explains at page 9 of his direct testimony that active management  
12 of Rhode Island's gas portfolio by National Grid will provide the Company greater flexibility  
13 to optimize the value of certain assets while ensuring full compliance with FERC regulations.  
14 By contrast, new regulations established by FERC through Order No. 712 may limit the  
15 ability of external asset managers to accomplish similar results. Thus, the proposed in-  
16 sourcing of asset management activities provides some potential for expanded customer  
17 benefits.

18  
19 **Q. WHY SHOULD THE COMMISSION CONSIDER NATIONAL GRID'S**  
20 **PROPOSAL TO IN-SOURCE OR SELF-MANAGE THE COMPANY'S NATURAL**  
21 **GAS ASSETS AT THIS TIME?**

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1 A. Utilities as small as the former Providence Gas Company and Valley Resources found it  
2 costly and difficult to develop and maintain an in-house capability to perform the types of  
3 asset management activities that third-party asset managers could provide. But NGrid has  
4 the size and experience to offer a potentially cost-effective alternative to continued reliance  
5 on third-party asset management services. The Company is already providing similar  
6 services for its much larger natural gas distribution utility operations in New York and  
7 Massachusetts, and thus, it can provide its Rhode Island service territory considerable asset  
8 management experience and potential for economies of scale that would be difficult for a  
9 smaller utility to match. Moreover, the overall size and scope of its asset management  
10 activities may equal or exceed the size and scope of third-party asset managers' operations.

11  
12 **Q. DOES EXHIBIT SAM-2 ACCURATELY DEPICT THE MANNER IN WHICH NET**  
13 **REVENUE DERIVED THROUGH THE COMPANY'S MANAGEMENT OF GAS**  
14 **ASSETS WOULD BE SHARED BETWEEN NATIONAL GRID AND ITS RHODE**  
15 **ISLAND FIRM GAS SALES SERVICE CUSTOMERS?**

16 A. Yes, it does. In no event would the benefit, in terms of credits against gas costs, be less than  
17 \$1.0 million annually. Furthermore, to the extent that net asset management revenue exceeds  
18 \$1.0 million in a year, 80% of such excess will accrue to the benefit of ratepayers.

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1

2 **Q. ON WHAT BASIS DO YOU CONCLUDE THAT THE PROPOSED NGPMP IS**  
3 **COMPATIBLE WITH THE COMPANY'S GAS PROCUREMENT INCENTIVE**  
4 **PLAN (GPIP)?**

5 A. The proposed NGPMP continues the use of dispatch procedure and indexed pricing  
6 mechanism that have been employed in the Company's interface with its third-party asset  
7 managers in recent years. As a result, gas cost savings achieved through the GPIP will  
8 continue to flow directly to customers and those benefits will not be altered by the operation  
9 of the NGPMP.

10

11 **Q. DO YOU HAVE ANY CONCLUDING COMMENTS REGARDING NGRID'S**  
12 **PROPOSED NATURAL GAS PORTFOLIO MANAGEMENT PLAN?**

13 A. Yes, I do. The Division believes that adoption of National Grid's NGPMP at this time  
14 represents a reasonable alternative to continued reliance on out-sourced third-party asset  
15 management services. That change will impose new requirements on the Company, the  
16 Commission and the Division to ensure that the overall costs and benefits of the program  
17 continue to produce reasonable and appropriate results over time. In the absence of readily  
18 identifiable external benchmarks for measuring the success of the program, the Company  
19 will need to be forthcoming with sufficient internal data to provide confidence that levels of  
20 costs incurred and benefits achieved are consistent with the public interest and in fact,  
21 reasonably optimize the benefits derived from Rhode Island's natural gas assets. Moreover,

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1 given the rather extreme nature of recent changes in energy prices in general, and natural gas  
2 prices in particular, the initial parameters may require some refinement or adjustment over  
3 time. For this reason, the Commission may want to view the initial years of this program as  
4 experimental and specifically provide for a detailed review of the parameters of the program  
5 after the first two years of its operation with the potential that the program parameters could  
6 be refined, revised, or even terminated before the start of a fourth year of operation.

7

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

9 A. Yes, it does.

10

11

12

13

14