BEFORE THE

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

PUBLIC UTILITIES COMMISSION

RE:	**THE NARRAGANSETT ELECTRIC COMPANY: INVESTIGATION AS TO THE PROPRIETY OF PROPOSED TARIFF CHARGES**	**))))**	**DOCKET NO. 4065**

SURREBUTTAL TESTIMONY OF

MATTHEW I. KAHAL

ON BEHALF OF THE

DIVISION OF PUBLIC UTILITIES AND CARRIERS

OCTOBER 27, 2009

BEFORE THE

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SURREBUTTAL TESTIMONY
OF
MATTHEW I. KAHAL

A. Introduction

Q. Have you previously testified in this proceeding?

A. Yes. On September 15, 2009, I submitted Direct Testimony on behalf of the Division of Public Utilities and Carriers ("the Division"). My testimony addressed the fair rate of return that should be awarded in this case to Narragansett Electric Company ("Narragansett" or "the Company"). My September 15, 2009 testimony recommends an overall return of 7.78 percent, including a 10.1 percent cost of equity. This compares with the Company's proposal of an 8.98 percent overall return and 11.6 percent return on common equity. My Direct Testimony includes a statement of my qualifications.

Q. What is the purpose of your surrebuttal testimony?

A. On October 6, 2009, the Company submitted its rebuttal filing, which includes the rebuttal testimony of Mr. Paul R. Moul and Ms. Julie Cannell that responds to my Direct Testimony on fair rate of return. My surrebuttal testimony responds to the rebuttal testimony of witnesses Moul and Cannell. In addition, I have updated the estimated cost of long-term debt and the resulting overall rate of return. Please note that capital costs, including the cost of equity, have continued to moderate over the last several months. However, since only about six weeks have passed since the preparation of my Direct Testimony, I am not updating my cost of equity estimate and recommendation. I continue to believe that 10.1 percent would be a reasonable and fair return on equity (ROE) award in this case.

Q. Have either Mr. Moul or Ms. Cannell provided revised or updated cost of capital information in rebuttal testimony?

A. No, as will be discussed later, Ms. Cannell's rebuttal testimony is limited to discussing investor attitudes and the general risk trends and circumstances for electric utilities. She provides no cost of equity, capital structure or cost of debt analysis, nor does she take issue with any of my cost of equity studies.

Mr. Moul originally prepared his own cost of capital studies and recommendations in the spring 2009. Financial markets have improved substantially since then, and the cost of capital has declined. Despite such changes, Mr. Moul provides no update in his rebuttal testimony, other than some very limited updated information in connection with his Capital Asset Pricing Model (CAPM) study.

It should be noted that Mr. Moul does not contest either my cost of short-term debt or long-term debt to be used for setting the fair rate of return in this case. Those cost rates are significantly lower than Mr. Moul's assumptions, reflecting the declining trend in capital costs in recent months.

B. Cost of Capital Update

Q. What is your update to your rate of return recommendation?

A. Due to the declining trend in corporate long-term debt costs, I have updated my assumed long-term cost of debt from 6.1 percent to 5.6 percent. This reduces Narragansett's overall return from 7.78 to 7.54 percent, as shown on Schedule MIK-1, October 2009 Update. Please note that I have not changed the cost of short-term debt from the 1.6 percent figure in my Direct Testimony, even though the

Company's short-term debt cost rate at this time is below 1.0 percent. While the short-term cost of debt is not likely to increase significantly in the near term (based on recent Fed statements), it is likely to increase somewhat at some future point in time, and my 1.6 percent cost rate reflects that.

Q. What is the basis for your 5.6 percent cost of long-term debt?

A. The Company's filed case bases the estimated cost of long-term debt on the cost of ten-year notes (plus 9 basis points for issuance and debt discount expense) to be issued in November 2009. With the improvements in corporate bond markets, the August 2009 yield on single-A long-term (i.e., 20 to 30-year) utility bonds (as published by Moody's) was 5.7 percent. According to Federal Reserve data, the corresponding yield on long-term (i.e., 20 to 30-year) Treasury bonds in August was 4.3 percent. Hence, the single-A yield utility credit spread was about 140 basis points (i.e., 5.7% minus 4.3%).

For the most recent month, September, 10-year Treasury yields averaged 3.4 percent, with 30-year Treasury bonds yielding 4.2 percent. Treasury yields as of mid-October are quite close to these September average figures. The average of the 10-year and 30-year Treasury yields is about 3.8 percent. Including a credit spread of 170 basis points (as compared to the observed 140 basis points in August) plus 10 basis points for issuance expenses produces an updated cost of long-term debt estimate of 5.6 percent.

If there is a material change in market conditions between now and the hearings on rate of return, I expect to update my cost of debt estimate.

Q. Do you agree with the Company's apparent plan for issuing only ten-year debt?

A. Not necessarily. Given the current very favorable conditions in debt markets (noted by Ms. Cannell), I believe that it would be prudent for at least a portion of the planned issuance to be 20 or 30-year debt, if feasible. If all debt issued is to be a tenor of ten years, then 5.6 percent probably would be too high, based on current conditions.

Q. Do you have any evidence that utilities can issue new debt at cost rates below 5.6 percent?

A. Yes, as I noted in my Direct Testimony, AGL Resources issued $300 million of long-term notes at 5.25 percent in early August 2009. Narragansett's affiliate, Niagara Mohawk Power, recently issued $750 million of ten-year notes at a yield of approximately 5 percent. In fact, Mergent's September 2009 *Bond Record* identifies a current yield to maturity for those notes of 4.59 percent. Niagara Mohawk has a credit rating that is the same as Narragansett's.

Q. Are you revising your recommended common equity ratio?

A. No. While Mr. Moul objects to my recommended 47.5 in favor of the Company's preferred 50 percent, he presents no evidence that this is what the Company actually will use during the "rate year". Moreover, he has no evidence that 50 percent is more appropriate than my proposed 47.5 percent in achieving a cost minimizing capital structure, which should be the Company's objective. Mr. Moul only knows that 50 percent is the Company's stated objective. My Direct Testimony demonstrates that the average equity ratio in the electric and gas utility industries is below 50 percent, including both of my proxy groups.

In my Direct Testimony, page 9, I present the authorized common equity for each National Grid utility company for cases decided this decade. These authorized common equity ratios average 46.1 percent, which is slightly below my recommended 47.5 percent. I am *not* arguing that this Commission should emulate the rate decisions reached by other state commissions. Rather, I believe this information is relevant because these companies have been able to operate successfully with strong credit ratings with these regulatory capital structures.

Q. Mr. Moul objects to your reference to other National Grid utilities' authorized returns because some of those returns were the result of rate case settlements. Does his observation mean that this information is not relevant?

A. No, I believe he misses the point. The fact that some of these authorized returns were settlement figures merely indicates that the utilities found them to be acceptable. The larger point is that over time these utilities have been able to operate successfully and retain strong, single-A credit ratings with these authorized returns, including an average 46 percent equity ratio. The fact that the authorized returns/equity ratios in many of those cases result from settlements cannot change those facts.

C. Response to Ms. Cannell

Q. What is the purpose of Ms. Cannell's rebuttal testimony?

A. Her testimony presents what she believes to be the perspectives and concerns of some utility investors. She also provides a discussion of the various risks that electric utilities currently face, including risks faced by distribution utilities, as well as the attitudes of credit rating agencies. It is important to note that Ms. Cannell presents no (quantitative) cost of capital analysis and does not take issue with or challenge my cost of equity studies.

Q. Does Ms. Cannell demonstrate that your 10.1 percent recommendation is inadequate?

A. No. She presents no analysis demonstrating that a 10.1 percent return on equity would not be adequate for Narragansett to meet its financial or utility obligations or to obtain access capital markets on reasonable terms. With regard to access to new equity capital, it is currently the Company's plan to drastically reduce its equity capitalization, not increase it.

Q. Do you dispute all of the major points in her testimony?

A. No, to the contrary, I agree with many of her arguments and observations. The problem is that they fail to support the Company's 11.6 percent return on equity request as being a necessary and appropriate return award – particularly at a time when the Company's Rhode Island customer base is experiencing so much financial distress. Consider the following assertions in her testimony.

(1) *Investors find 11.6 percent attractive.*

> At page 6 she states that Mr. Moul's "11.6 percent…would likely be viewed favorably by the investment community…."

I have little doubt that investors indeed would find the proposed 11.6 percent return on equity award to be highly attractive, but that does not mean such a return is fair, appropriate or consistent with the Company's cost of equity. An excessively generous return award typically is attractive to investors, but harmful to customers.

(2) *A reasonable rate of return is beneficial to both customers and investors. (page 8)*

I fully agree that the return award should be "reasonable", and the cost of capital standard generally should be employed as guidance in meeting that standard. In that regard, I believe that my 10.1 percent fully meets that standard and therefore is reasonable.

(3) *Distribution electrics are subject to important risk factors. (page 14)*

Ms. Cannell discusses a range of utility risk factors including the need to raise capital and the problem of regulatory lag. I agree that distribution electrics face a range of business risks, though these risks typically are less than those facing vertically-integrated electrics and far less than those confronting merchant power providers. My 10.1 percent recommendation fully accounts for those risks, and this return is far above the risk-free return. Risk, of course, is relative, and as I noted in my Direct Testimony, Narragansett is viewed by credit rating agencies as having very low business risk.

(4) *Rhode Island regulation is regarded by investors as being favorable.*

At page 18, Ms. Connell states, "It bears mention that Rhode Island regulatory policy has been reasonably constructive regarding cost recovery over time."

I have no disagreement with her finding, which appears to be consistent with credit rating agency reports for Narragansett that I have reviewed.

(5) *Utilities in late 2008 and early 2009 were adversely affected by the global financial crisis, but that crisis has eased. (page 20)*

Within the past year, the cost and availability of investment funds have improved dramatically for corporations with strong credit ratings. Equity markets have stabilized and long-term debt credit spreads have returned to more normal levels. Severe credit restriction problems remain for various sectors of the economy including consumer loans, commercial real estate, small businesses that depend on bank borrowing for liquidity and distressed entities. These problems continue to hamper the emerging U.S. economic recovery, but they do not increase the cost or restrict the availability of capital for utilities with strong credit ratings. There is no basis for even implying the financial crisis should serve as a basis for increasing Narragansett's authorized rate of return, based on current conditions.

(6) *Electric utilities are "safe havens" during periods of financial market turmoil. But now utilities are being outperformed by non-regulated companies. (page 24)*

I generally agree with this depiction of utilities, and this is precisely why utilities are considered to be far less risky than unregulated companies. The currently prevailing low risk, low cost of capital environment means that during the economic recovery – or even during normal circumstances – non-regulated companies should outperform low-risk utilities in terms of providing market returns on investment. This relatively modest return outlook for utilities is completely consistent with utilities being less risky than non-regulated companies.

D. <u>Response to Mr. Moul</u>

Q. What arguments does Mr. Moul set forth in his Rebuttal Testimony pertaining to the equity return?

A. That portion of his rebuttal testimony addresses several areas, with some issues addressed only briefly. A pervasive problem with his testimony is his lack of acknowledgement that capital costs have fallen and capital markets for credit-worthy corporations have improved significantly since the time period of the preparation of his Direct Testimony, about six months ago (with one small exception that I will discuss). Despite these undeniable changes, he continues – without any support – to recommend an ROE award of 11.6 percent.

The ROE topics he addresses are as follows:

- He criticizes my references to growth measures (for DCF purposes) other than securities analyst earnings growth projections.
- He defends his decision to include in his equity return recommendation his "leverage adjustment" in order to provide additional investor compensation.
- Using updated evidence (his only update), he tries to demonstrate that the market risk premium that I employed in my Capital Asset Pricing Model ("CAPM") study is too low.
- In connection with his own CAPM study, he defends his inclusion of a "size adder".
- Mr. Moul attempts to defend his historic industry risk premium study, arguing that my corrections to his study are improper and produce results that are too low.

- Finally, he provides a very brief defense of his "comparable earnings" study. (Please note that I do not respond to his discussion on this topic since Mr. Moul makes clear his ROE recommendation does not rely on this study, and he concedes that it is not a market cost of equity estimation method.)

(1) <u>Mr. Moul's DCF Comments</u>

Q. Mr. Moul appears to argue that the DCF evidence in this case should be deemphasized. Why?

A. Mr. Moul seems to question the validity of the DCF method arguing that: (1) the model requires the use of restrictive assumptions; and (b) for regulated utilities it is somehow "circular." The alleged circularity apparently arises because the earnings/dividend growth rate for a utility is a crucial data input in the DCF model. However, the regulatory commission itself (in a sense) can influence that growth rate through its ROE award. In that manner, the regulatory commission therefore helps to determine the DCF model result, according to Mr. Moul's argument.

Q. Do his DCF criticisms have merit?

A. No. Like all economic models the DCF makes use of simplifying assumptions to make the models easier to apply and more transparent. While such assumptions can affect the calculated results, Mr. Moul has provided no evidence that these assumptions cause the model to produce cost of equity results that are unduly or improperly low. If anything, the opposite may be true. Moreover, if Mr. Moul objects to the DCF model assumptions, he is free to relax them and calculate his results using alternative assumptions more to his liking. He did not do so. The DCF is a flexible model capable of employing a wide range of assumptions and functional forms.

Mr. Moul's "circularity" concern is imagined and not real. In my study, I employed two proxy groups and a total of 17 utility companies from across the U.S. Since none are regulated by this Commission, the claimed "circularity" could not take place. In addition, even though a given commission might be able to influence the earnings of a given utility, this would not distort the DCF results. This is because that company's stock price would adjust to the change in earnings outlook in accordance with the market forces. For example, while a low ROE award might lower a utility's projected earnings growth rate, the company's stock price would fall and dividend yield would increase by an offsetting amount. Mr. Moul overlooks this market-based feature of the DCF model in imagining a circularity problem that simply does not exist.

Q. Do financial treatises validate this claim of circularity for the DCF model?

A. Not to my knowledge, and Mr. Moul does not cite to any authority in support of his allegation.

Q. Does Mr. Moul criticize your DCF application?

A. Mr. Moul criticizes certain growth rate indicators that are cited in my testimony. My primary evidence on growth is the analyst published earnings growth rates projections prepared by securities analysts, and he does not take issue with that evidence. However, he does object to my references to Value Line growth rates other than earnings (i.e., earnings retention, dividends and book value), even though those same measures also are cited in his own testimony in support of his DCF study. He argues that projected dividend and book value growth measures should be given no weight, and that my earnings retention growth rates should be modified. Specifically, he increases my gas group earnings retention growth rate to 5.98 percent and my electric group earnings retention growth rate to 3.96 percent.

Q. Would his criticisms and adjustments change your DCF results?

A. No, I don't believe so, although Mr. Moul inexplicably fails to provide his calculations of the 5.98 percent and 3.96 percent earnings retention growth rates. This makes it impossible for me to verify or dispute how he calculated those adjustments.

Please note that my gas utility DCF study employed a DCF growth rate range of 5.0 to 5.5 percent. At page 17, line 14 of his rebuttal testimony, Mr. Moul insists that the "correct" growth rate to be used in this gas group DCF study is 5.24 percent – which is nearly the exact midpoint of my recommended 5.0 to 5.5 percent range. Thus, we have no disagreement.

It is true that his adjusted electric distribution earnings retention growth rate of 3.96 percent is a somewhat higher figure than my 3.5 percent figure that I took directly from Value Line. However, for DCF purposes I employed a growth rate range, 3.8 to 4.8 percent. Mr. Moul's modified 3.96 percent figure is comfortably within that range and is actually below the midpoint of that range, which would be 4.3 percent. Thus, his modification has no affect on my electric distribution DCF results.

Q. Mr. Moul advocates ignoring dividend and book value growth. Do you agree?

A. Like Mr. Moul, I tend to discount the usefulness of dividend growth projections for a number of reasons, and I did not rely on it for my DCF studies. However, I tend to disagree with him concerning the use of projected of book value per share since utilities are regulated on a cost of service (i.e., "book value") basis. That is, on a long-term basis, the growth in book value provides a useful indicator of the expected growth path for earnings and dividends.

Q. Has Mr. Moul's rebuttal testimony identified any errors or flaws in your DCF evidence?

A. No. My DCF evidence supports a cost of equity for Narragansett of 10.1 percent or less, although I do provide a range of results. None of Mr. Moul's criticisms or adjustments alter my DCF findings.

Q. What is the relevance of recent market trends to your DCF results?

A. My studies employ market data for the six months ending August 2009. Since stock prices have been rising in recent months (less so for utilities than non-regulated companies), the dividend yield component of my DCF studies is conservatively high. My original studies used dividend yields of 4.57 percent for the gas group and 5.81 percent for the electric distribution group. As of October 16, 2009, those proxy group average yields were somewhat lower, i.e., 4.28 percent for the gas group and 5.40 percent for the electric group. (See Schedule MIK-7, page 1 of 1.)

Q. Mr. Moul's rebuttal testimony provides a defense of his leverage adjustment. Does he provide any further analysis demonstrating the need for this adjustment?

A. No, he does not. Mr. Moul's leverage adjustment, quite simply, is not in any way part of the cost of equity. It is included as additional investor compensation because under standard regulation book value capital structure and not market value capital structure is used for ratemaking. This adjustment therefore is a collateral attack on cost-based ratemaking.

Q. Your direct testimony states that there is little regulatory support for Mr. Moul's leverage adjustment. Does he dispute your claim in his rebuttal testimony?

A. No, he does not. He does attempt to deny that his adjustment constitutes a "market/book" adjustment to cost of equity, but in fact that is what it is (albeit a complex one). That is, the higher are the prevailing market/book ratios for his proxy companies, the greater is the magnitude of his leverage adjustment.

Q. Is it your position that a company's degree of debt leverage has no effect on its cost of equity?

A. No, not at all. All else equal, the more leverage a company has (i.e., the weaker its balance sheet), the greater is its cost of equity. (Of course, other factors also influence the cost of equity.) Fortunately, the DCF study automatically and fully captures all aspects of risk including the degree of debt leverage. For example, my gas utility DCF study fully accounts for the capital structures of the nine proxy companies, and therefore no "leverage adjustment" is needed to establish the cost of equity for the proxy group. Mr. Moul is free to argue that Narragansett is riskier than the proxy group, due to its greater debt leverage or for any other reason. He makes no such argument.

His approach is to include a leverage adjustment even if Narragansett is equal in risk to the proxy group average, and this is simply wrong. No adjustment is needed or warranted unless a risk increment for Narragansett relative to the proxy group can be convincingly demonstrated.

Q. Is Narragansett more leveraged than either of your two proxy groups?

A. No, there is no evidence that it is, and therefore no adjustment for leverage is needed.

(2) <u>The CAPM Method</u>

Q. What issues does Mr. Moul raise in rebuttal concerning the CAPM?

A. Mr. Moul argues that my equity risk premium range (relative to long-term Treasury bonds) of 5 to 8 percent is too low. He also attempts to defend the "size adjustment" (i.e., an increase to Narragansett's return on equity for allegedly being a small company) that he included in his study.

Q. What risk premium did Mr. Moul adopt for his original CAPM study?

A. He selected 8.8 percent. This figure is the average of a long-term historical risk premium of 6.1 percent and a projected stock market risk premium of 11.54 percent. This latter figure is the average of his DCF-type calculations using the median Value Line stock and the S&P 500. My Direct Testimony explains why his 11.54 percent is an outlandishly high figure, and that discussion need not be repeated here.

Q. Has Mr. Moul provided an update?

A. He has provided a partial update, specifically updating the projected component (i.e., the 11.54 percent) of his equity market risk premium. The historical 6.1 percent figure, of course, cannot be updated.

The following table shows the update of his projected risk premium.

	Original	September Update	Change
Value Line	17.22%	13.68%	(3.54%)
S&P 500	13.86%	11.13%	(2.73%)
Average Return	15.54%	12.41%	(3.13%)
Average Risk Premium	11.54%	8.41%	(3.13%)

In both cases, the average risk premium is calculated using a 4 percent Treasury bond yield, and the update shows a dramatic 3 percentage point decline in the equity risk premium, from 11.54 to 8.41 percent, between his original testimony and his September rebuttal testimony.

Following Mr. Moul's methodology, this projected premium then must be averaged with the 6.1 percent historic risk premium: (8.41% + 6.1%)/2 = 7.25%. Mr. Moul's risk premium update of 7.25 percent therefore lies well within my 5 to 8 percent range.

For CAPM purposes at this time I assume a 4.25 percent risk free rate (slightly higher than what Mr. Moul assumes). Using Mr. Moul's updated risk premium of 7.25 percent and a Value Line beta of 0.7, this produces the following CAPM cost of equity calculation:

$$K_e = 4.25\% + 0.7\ (7.25\%) = 9.33\%.$$

Hence, Mr. Moul's risk premium update supports a return on equity for Narragansett of less than 10 percent.

Q. Does Mr. Moul provide a persuasive defense of his "size adjustment?"

A. I presented two objections to his size adjustment. First, he has no evidence that size is a significant factor in determining a company's cost of equity, particularly for low-risk utilities. It appears that the issue in connection with utilities has not even been studied. Second, Narragansett for cost of equity purposes is <u>not</u> small. It is wholly owned by National Grid, a very large company with more than $20 billion of assets.

Mr. Moul fails to respond at all to the first point, and on the second point he simply states that we must be compelled to view Narragansett as a totally separate entity from National Grid.

Q. Is there any merit to his "stand-alone" argument?

A. No. Narragansett is financially fully integrated with National Grid. The common equity of Narragansett is that of National Grid. Moreover, there may be instances when Narragansett may be able to obtain scale economies cost savings from being part of the National Grid system (and, in turn, Narragansett contributes to those scale economies). No one would reasonably suggest that cost savings scale economies pertaining to the provision of utility service belong to shareholders, and we should set Narragansett's rates as if those scale economies did not exist. Yet, that is precisely what Mr. Moul is advocating through his erroneous "size adjustment." His position on this issue, which is at odds with standard and sound ratemaking, should be rejected.

(4) <u>Risk Premium</u>

Q. What is Mr. Moul's rebuttal position concerning the Risk Premium analysis?

A. I criticized Mr. Moul's Risk Premium study as being out of date. Upon updating his risk premium data, I obtained far lower Risk Premium results, approximately consistent with my ROE recommendation in this case.

In rebuttal, Mr. Moul seems to have completely ignored the central criticism – the need to update. Instead, he objects to my Risk Premium calculation update arguing: (a) the geometric historic mean risk premium measure should be ignored because it is too low (even though Mr. Moul himself seems to use it!); and (b) the median historic risk premium measure also should be included in reporting the Risk Premium results.

Q. What is your response?

A. In response to Mr. Moul, I again will present the Risk Premium calculations but just using the arithmetic historic mean (for both the full time period and the last 25 years), omitting the geometric historic mean, per Mr. Moul's "too low" argument.

Full period: 5.7% + 5.02 (88%) = 10.1%

Last 25 years: 5.7% + 4.08 (88%) = 9.3%

For these cost of equity calculations, I have updated the single-A bond yield to 5.7 percent, per my update to Schedule MIK-2, page 4 of 4. I also include Mr. Moul's 88 percent Narragansett risk adjustment factor. This shows a cost of equity range using the arithmetic historic mean, Mr. Moul's risk premium data, Mr. Moul's Narragansett risk factor and a current single-A bond yield of 9.3 to 10.1 percent.

Finally, it is incorrect to attempt to measure the historic average return on an asset or risk premium using the "median" measure. I know of no published studies that use or even identify that statistical measure as being a method of estimating the historic risk premium, and Mr. Moul was not able to identify any in his rebuttal testimony.

(5) <u>Other Issues</u>

Q. Are there other issues that you believe warrant mention at this time?

A. Yes. A central concern that I have with Mr. Moul's testimony is that his cost of equity is inextricably tied exclusively to his seven proxy RDM companies. By doing so, he has no analysis or information that address the following two crucial questions:

(a) What is the cost of equity benefit that Narragansett ratepayers would obtain if Dr. Tierney's RDR Plan is adopted?

(b) What is the cost of equity and fair rate of return in this case for Narragansett if Dr. Tierney's RDR Plan is not adopted by the Commission?

After reviewing his rebuttal testimony, those two crucial questions remain unanswered by Mr. Moul.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

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OCTOBER 26, 2009

NARRAGANSETT ELECTRIC COMPANY

Provisional Rate of Return Summary

Capital Type	% of Total[1]	Cost Rate	Weighted Cost
Long-Term Debt	47.33%	5.6%[2]	2.65%
Preferred Stock	0.19	4.50	0.01
Short-Term Debt	4.98	1.60[3]	0.08
Common Equity	47.50	10.10[4]	4.80
Total	100.00%	--	7.54%

[1] Source: Based on Schedule NG-PRM-1 for preferred stock and long-term debt. Common equity is reduced from 50.0 to 47.5 percent on a provisional basis. See testimony for discussion.

[2] Based on September 2009 10-year and 30-year Treasury yields plus 170 basis point credit spread plus 10 basis points for debt discount and expense.

[3] Estimate based on most recent 12-month average. See page 2 of this Schedule.

[4] Source: Schedules MIK-4 and MIK-5 and testimony.

NARRAGANSETT ELECTRIC COMPANY

U.S. Historic Trends in Capital Costs
(Continued)

	Annualized Inflation (CPI)	10-Year Treasury Yield	3-Month Treasury Yield	Single-A Utility Yield
2007				
January	2.1%	4.8%	5.1%	6.0%
February	2.4	4.7	5.2	5.9
March	2.8	4.6	5.1	5.9
April	2.6	4.7	5.0	6.0
May	2.7	4.8	5.0	6.0
June	2.7	5.1	5.0	6.3
July	2.4	5.0	5.0	6.3
August	2.0	4.7	4.3	6.2
September	2.8	4.5	4.0	6.2
October	3.5	4.5	4.0	6.1
November	4.3	4.2	3.4	6.0
December	4.1	4.1	3.1	6.2
2008				
January	4.3%	3.7%	2.8%	6.0%
February	4.0	3.7	2.2	6.2
March	4.0	3.5	1.3	6.2
April	3.9	3.7	1.3	6.3
May	4.2	3.9	1.8	6.3
June	5.0	4.1	1.9	6.4
July	5.6	4.0	1.7	6.4
August	5.4	3.9	1.8	6.4
September	4.9	3.7	1.2	6.5
October	3.7	3.8	0.7	7.6
November	1.1	3.5	0.2	7.6
December	0.1	2.4	0.0	6.5
2009				
January	0.0%	2.5%	0.1%	6.4%
February	0.2	2.9	0.3	6.3
March	(0.4)	2.8	0.2	6.4
April	(0.7)	2.9	0.2	6.5
May	(1.3)	2.9	0.2	6.5
June	(1.4)	3.7	0.2	6.2
July	(2.1)	3.6	0.2	6.0
August	(1.5)	3.6	0.2	5.7
September	(1.3)	3.4	0.1	5.5 (p)

Sources: *Economic Report of the President, Mergent's Bond Record, Federal Reserve Statistical Release, Consumer Price Index Summary*

NARRAGANSETT ELECTRIC COMPANY

Mid-October 2009
Spot Dividend Yields*

Electric Distribution Group	
C. H. Energy	4.9%
Central Vermont	4.6
Consolidated Edison	5.8
Northeast Utilities	4.1
NSTAR	4.8
Pepco Holdings	7.3
UIL Holdings	6.3
Average	**5.40%**

Gas Distribution Group	
AGL Resources	4.7%
Atmos	4.6
LaClede Gas	4.7
NICOR	4.9
Northwest Natural	3.8
Piedmont Gas	4.5
South Jersey Ind.	3.2
Southwest Gas	3.7
WGL	4.4
Average	**4.28%**

*Source: Yahoo Finance, October 16, 2009