



STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

DIVISION OF PUBLIC UTILITIES AND CARRIERS

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PUBLIC UTILITIES COMMISSION

Luly Massaro, Clerk
Division of Public Utilities and Carriers
89 Jefferson Boulevard
Warwick, RI 02888

Re: Docket No. D-06-13

Dear Ms. Massaro,

I am writing on behalf of the Advocacy Section of the Division of Public Utilities and Carriers ("Advocacy Section") in connection with the above-entitled matter. The Advocacy Section has reviewed the pleadings, discovery responses, testimony and other papers that have been submitted by the parties in Docket No. D-06-13. Based upon our review, the Advocacy Section recommends that the Division approve the pending transaction between The Narragansett Electric Company, d/b/a National Grid (Nat'l Grid) and Southern Union Company (Southern Union) subject to the following two conditions: a) Nat'l Grid shall file a rate plan with the Public Utilities Commission within one year of the date that the Division issues an Order approving the transaction, and b) Southern Union shall place in escrow the sum of at least \$13 million on such terms and conditions as recommended by the Department of Attorney General.

With respect to the first of these conditions, the Advocacy Section observes that Nat'l Grid is amenable to filing a rate plan within the one-year time-period, and does not oppose making the filing requirement as a condition of the transaction. (Gerwatowski, Rebuttal Testimony at 4). The Advocacy Section deems such a condition prudent since the filing requirement will serve to bring to the forefront each of the six other rate related issues discussed below.

In connection with the recommended escrow requirement, the Advocacy Section generally defers to the legal expertise of the Department of Attorney General and the Department of Environmental Management in the area of the enforcement of environmental laws. The Advocacy Section's only comment is that the magnitude of the recommendation (\$55 million) appears to be somewhat excessive. The parties themselves, acknowledge that Southern Union's Tiverton environmental liability may range between \$30 to \$55 million. Further, Southern Union appears to have several sources of funds external to the company to pay for the liability: Cost Recovery Per Directives of the MDTE, Insurance Recovery, and Reimbursement of Responsible Parties. (Response to Division Data Request 4-3).

We recognize that our review in this case focused on the petitioners' proposed transaction from the perspective of its likely impact on gas and electric customers, both in terms of rates and service. On the issue of the transaction's impact on the State's ability to enforce and collect on a potential environmental liability judgment against Southern Union in the future, the opinion of the Rhode Island Department of Environmental Management and the Rhode Island Attorney General's Office, the state's chief environmental enforcement and law enforcement agencies, respectively, should be accorded serious consideration.

The position of these agencies is that Southern Union's ongoing corporate reorganization, in combination with the pending transaction, leaves the State of Rhode Island in a materially less secure position than it otherwise would be in if the transaction is not consummated, should the State obtain a judgment against Southern Union to remediate the Tiverton liability. Further, these agencies contend that recent changes in how the courts have dealt with CERCLA, together with Southern Union's ongoing corporate reorganization that includes the pending transaction, at a minimum, casts some doubt on the ability of the State to collect on a judgment against Southern Union.

If the transaction is consummated by August 25, 2006, then Southern Union will receive a tax deferral benefit of at least \$13 million. (Response to Division Data Request 5-4 and 9-2). Under the Purchase and Sale of Assets Agreement dated March 16, 2006, Nat'l Grid and Southern Union each have the right to extend closing of the transaction up to an aggregate of 120 days beyond the August 25, 2006 (the "Upset Date") (Responses to Division Data Request 1-3 & 1-4) (Direct Testimony of David J. Effron at 21). And Section 11.2 of the Purchase and Sale of Assets Agreement dated March 16, 2006 specifically provides that "...the structuring of the transactions in a manner that qualifies the transactions as part of a like-kind exchange shall not be a condition of the Closing." Accordingly, Southern Union does not possess a reasonable expectation that the transaction will close by that deadline. In accordance with that lack of such an expectation, the parties also have represented to the Advocacy Section that they are committed to consummating the transaction whether or not Southern Union receives the tax benefit. It does not appear unreasonable, then, for the Division to require Southern Union to hold the sum of at least \$13 million in escrow as a condition of consummating

the transaction, on such terms and conditions as recommended by the Attorney General, particularly, in light of the increased risk to the State of Rhode Island that the Attorney General opines will materialize if this deal proceeds.

Although the Advocacy Section recommends imposing the aforementioned two conditions on the pending asset purchase and sale, discussion of the commitments that Nat'l Grid has made once the transaction has been approved is also warranted.

Commitment 1 - Nat'l Grid is committed to freezing gas delivery rates until there is a decision on the new rate plan. (Gerwatowski, Rebuttal Testimony at 3) (June 29, 2006 Transcript of Record at 93-94). Accordingly, in the short term, consummation of the Purchase and Sale of Assets Agreement dated March 16, 2006 cannot detrimentally impact ratepayers.

Commitment 2 - Nat'l Grid commits that in the next rate case, the company will not recognize good will for ratemaking purposes. Nat'l Grid and the Advocacy Section interpret this commitment to permit Nat'l Grid to seek approval of a shared saving plan that allows the company and customers to share demonstrated cost savings benefits arising from the transaction. (Gerwatowski, Rebuttal Testimony at 8) (June 29, 2006 Transcript of Record at 91-92). Based on past experience with such saving plans, upon approval of the next rate plan ratepayers may anticipate that rates, both in the short and longer term, will be lower than they otherwise would be absent the transaction.

Commitments 3 and 4 - Nat'l Grid is committed to excluding transaction costs from any future cost of service, and recognizes that integration costs should be recovered only to the extent that the company can demonstrate that savings attributable to the acquisition, exceed such costs. (June 29, 2006 Transcript of Record at 95-97).

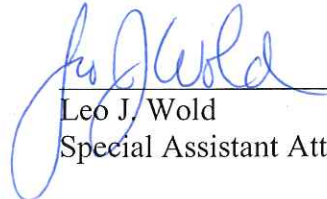
Commitments 5 and 6 - Nat'l Grid cannot make firm commitments with respect to Accumulated Deferred Income Taxes (ADIT) and Post Retirement Benefit Other than Pension (PBOP) expenses due to the fact that complexities in the accounting for these items render their determination imprecise at the present time. (Laflamme Rebuttal Testimony at 3-4) (June 29, 2006 Transcript of Record at 105). Nonetheless, the company, again, acknowledges and affirms the principle that these items will not place customers in any worse position than they otherwise would have been in had the transaction not been consummated. (Gerwatowski Rebuttal Testimony at 9).

With these commitments in place, and, subject to imposition of the one-year filing and escrow requirements discussed above, the Advocacy Section recommends that the

Division approve the Purchase and Sale of Assets Agreement between Nat'l Grid and Southern Union dated March 16, 2006.

Advocacy Section of the Division of Public
Utilities and Carriers

By its attorneys,



Leo J. Wold
Special Assistant Attorney General

cc: Service List