

July 11, 2006

VIA HAND DELIVERY & ELECTRONIC MAIL

Luly E. Massaro, Division Clerk
RI Division of Public Utilities & Carriers
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Warwick, RI 02888

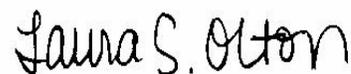
RE: Docket D-06-13 - Joint Petition of The Narragansett Electric Company and Southern Union Company for Approval of Purchase and Sale of Assets
Post-Hearing Memorandum

Dear Ms. Massaro:

Enclosed please find five (5) copies of a post-hearing memorandum of The Narragansett Electric Company, d/b/a National Grid, in the above-captioned proceeding.

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

Very truly yours,



Laura S. Olton

Enclosures

cc: Docket D-06-13 Service List

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DIVISION OF PUBLIC UTILITIES AND CARRIERS**

**IN RE: PETITION OF THE NARRAGANSETT)
ELECTRIC COMPANY AND SOUTHERN)
UNION COMPANY)** **DOCKET No. D-06-13**

**POST HEARING MEMORANDUM OF
THE NARRAGANSETT ELECTRIC COMPANY,
D/B/A NATIONAL GRID**

July 11, 2006

Introduction

The Joint Petition before the Division seeks approval by The Narragansett Electric Company, d/b/a National Grid (“Narragansett” or the “Company”) to purchase the assets associated with the regulated gas distribution business owned and operated by Southern Union Company in Rhode Island. The statutory standard in this case is whether this transaction is in the public interest. The evidence in the record establishes that the standard has been met.

Narragansett projected substantial efficiencies to be gained and savings opportunities to be realized by consolidating both gas and electric services in the state, and no one has seriously disputed this potential. The Division’s Advocacy Section agreed that significant savings were possible and was concerned primarily with the secondary effects of the merger on the cost of service to assure that no increases would occur as the result of accounting for the acquisition. The Wiley Center sought special conditions for the benefit of low-income customers relating to issues that ultimately will be addressed by the Public Utilities Commission (“Commission”) in future proceedings, but no reason was given for the Division to deny approval of the transaction.

The only controversy arose around the environmental issue in the Bay Street neighborhood of Tiverton. With regard to that issue, the law of the case limited the inquiry to one very narrow question. Would Southern Union be financially capable of meeting an obligation to clean up the alleged contamination in the neighborhood if this transaction is allowed to occur and Southern Union is found liable for the clean up? On that question, the evidence supports the transaction going forward. The range of the cost for such an obligation was stipulated to be between \$30 million and \$55 million. In turn,

the evidence presented supported Southern Union’s financial capability to meet that obligation, even if the actual cost came in at the highest end of that range. Thus, the only question that the Division left for consideration in this case relating to Tiverton was answered in favor of approving this transaction.

Accordingly, based on the substantial evidence on the record, the Division should approve the Petition.

Discussion

Under Rhode Island General Laws § 39-3-25, a transaction between two utilities should be approved if the Division is satisfied “that the facilities for furnishing service to the public will not thereby be diminished, and that the purchase, sale, or lease and the terms thereof are consistent with the public interest...” R.I.G.L. § 39-3-25. The Division has stated that to make this determination, it examines “the record evidence for confirmation that ratepayers will not be harmed by the proposed mergers” and also looks “for substantiation that ratepayers would actually benefit from the mergers.” Order No. 16338, at p. 59 (July 24, 2000). In the past, the Division has found that the public interest has been met when “efforts being made to consolidate the rates and operations of the merging companies should ... result in a net benefit to the ratepayers.” *Id.* at 61. The evidence before the Division establishes that this legal standard has been met.

I. Public Interest – Benefits to Customers

Narragansett has shown, and the Division’s Advocacy Section has agreed, that this transaction will bring benefits to customers. The basis for going forward with this transaction is for the Company to achieve savings that can be shared with customers in

the form of a shared savings rate plan agreement, similar in structure to what has been approved by the Commission in the past for Narragansett. Such an agreement aligns the interests of Narragansett and its customers by establishing appropriate incentives to maximize savings. Narragansett's analysis has shown real savings and efficiencies to be gained through this transaction which will be permanently reflected in the Company's cost of doing business over the long term. The current gross annual savings estimate by the Company is \$4.9 million per year for Rhode Islanders. Narragansett Exh. 1, at p. 2; Narragansett Exh. 3 (Division Data Request 9-1). The Division should find that such concrete economic benefits are achievable through the cost savings produced by this transaction that could not be achieved absent the transaction. Under Commission precedent and Narragansett's commitment at the hearing, these savings will be investigated in detail and shared with customers in the rate plan that Narragansett has committed to file within twelve months after the close of the transaction.

A. Advocacy Section Concerns

The Advocacy Section's primary concerns focused on the future rate plan filing which will be before the Commission. The Company addressed and responded to each of these concerns in the record. Specifically, the Advocacy Section sought assurances from the Company about the Company's future rate treatment of the following items: 1) acquisition premium; 2) transaction costs; 3) integration costs; 4) pension and PBOP liabilities; and 5) accumulated deferred income taxes. The Division should rest assured that the record is clear with regard to each of these items and that the Advocacy Section can rely on the Company's commitments in this Division proceeding in a future rate

proceeding before the Commission.

1) Acquisition Premium

First, the Advocacy Section has stated that the acquisition premium, or goodwill, resulting from this transaction should not be recognized for ratemaking purposes under any circumstances. As described at the hearing by Mr. Gerwatowski, “it’s never been our intention to file a cost of service and ask for recognition of goodwill for ratemaking purposes which would be effectively recovering directly the acquisition premium in rates.” 6/29/06 Tr. at p. 92. Rather, as described above, Narragansett intends to file a rate plan with the Commission within twelve months of the Division’s order approving this transaction, which would include a shared savings mechanism. Such a shared savings mechanism is not an explicit recovery of acquisition premium. Rather, it allows the Company, if it is efficient and operating well, to share in the savings. While such an incentive mechanism has the effect of allowing Narragansett to recover some of the investment it is making in the purchase, the Company has stated that it will not explicitly seek to recover any portion of the acquisition premium in rates. Id.; See also Narragansett Exh. 1, at p. 8.

2) Transaction Costs

Second, the Advocacy Section has stated that transaction costs incurred by the Company should be treated as shareholder costs that are not recoverable from ratepayers. Advocacy Section Exh. 2, at p. 14. Narragansett has agreed that transaction costs related to the purchase of the assets would be excluded from any costs that go into the determination of rates. 6/29/06 Tr. at pp. 95-96.

3) Integration Costs

Next, the Advocacy Section has indicated that to the extent that integration costs result in the achievement of savings, such costs should be potentially recoverable. Advocacy Section Exh. 2, at p. 15. Specifically, if Narragansett can demonstrate that the acquisition has resulted in quantifiable savings, then the integration costs should be potentially recoverable as an element of the cost of service, to the extent that the costs do not exceed the savings. Id. Narragansett has agreed that integration costs would be treated like costs to achieve savings, which would be later worked out as part of the rate plan. 6/29/06 Tr. at p. 96. Thus, the Company agrees with the Advocacy Section regarding integration costs and this is not an issue before the Division at this time.

4) Pension and PBOP Liabilities

The Advocacy Section also discussed the Company's treatment of pension and PBOP liabilities for ratemaking purposes. The Advocacy Section agreed with Narragansett's proposed accounting treatment (establishing a regulatory asset to offset the additional pension and PBOP liability), but also stated that Narragansett should be required to verify that the proposed accounting treatment accomplishes its stated goal in future rate cases. Advocacy Section Exh. 2, at pp.16-17. At the hearing, the Company made it clear that its intent regarding the pension and PBOP liability is to have customers in the same economic position as they would have been absent the merger. 6/29/06 Tr. at pp. 105-06. Thus, this issue also has been resolved.

5) Accumulated Deferred Income Taxes ("ADIT")

Finally, the Advocacy Section expressed some concern with regard to the balance of ADIT deducted from the rate base resulting from the transaction. Advocacy Section

Exh. 2, at pp.18-19. Again, Narragansett committed that any rate plan filing to be made with the Commission would contain customer benefits in the form of cost savings and/or settlement credits that would more than offset this revenue requirement impact.

Narragansett Exh. 1, at pp. 8-9.

As a result, the Company has addressed all of the Advocacy Section's requests for clarification. All of these matters relate to a future rate proceeding before the Commission and need not be made conditions of this transaction. As Narragansett has committed, these adjustments will be addressed directly in the rate plan so that the overall rates to customers are not adversely affected by the transaction. The record in this proceeding is abundantly clear for the Division to rely on in the future Commission proceeding. Accordingly, the Division can be satisfied that benefits to customers shall derive from this transaction, and there is no need for the Division to condition its order on any rate-related matters.

B. The George Wiley Center Conditions

The George Wiley Center has recommended that the Division condition its order approving the transaction on: (1) a mandate for the Company to develop a targeted discount program with an effective arrearage management proposal; (2) a requirement that a deficit in payment for electric service not be used to terminate gas service and vice versa; and (3) assurance of the availability in the merged entity of dedicated supervisory call center staff to respond to emergency needs of low-income customers.¹ George Wiley Center Exh. 1, at pp. 6-7. Narragansett responded to these issues directly at the hearing.

¹ During the Wiley Center's Opening Remarks, the Wiley Center also requested numerous other conditions on the transaction, such as restoration of service only upon payment of a certain percentage of one bill, a

First, the Division cannot lawfully mandate the Company to develop a targeted discount program with arrearage forgiveness. Such a mandate is not within the Division's jurisdiction. In fact, the Legislature just addressed these matters when it passed "The Comprehensive Energy Conservation, Efficiency and Affordability Act of 2006." Public Law 2006, Chapter 257 (enacted 6/29/2006).² That being said, the Company made a commitment on the record to sit down to talk with the Wiley Center at the time the Company is proposing a rate plan and before the Company files such a rate plan. 6/29/06 Tr. at pp. 121-22. This commitment should satisfy the Wiley Center.

Second, the Company has repeatedly stated that it has made no decision whether it will want to consolidate bills in Rhode Island in the future. 6/29/06 Tr. at pp. 81-83, 111-12. This issue simply is not before the Division in this proceeding. Moreover, if the Company decided in the future that it wanted to consolidate bills, it has indicated that it would make a proposal to the Commission, notify parties, and the Wiley Center will have an opportunity to participate in such proceeding. *Id.* Again, if this matter arises, the Wiley Center will be able to take part in the process. In the meantime, the Company has committed that it will not turn off gas service due to arrearages on electric bills, and vice versa, unless and until such issues are placed before the Commission and the rules are appropriately modified. Narragansett Exh. 3 (Division Data Request 2-6). Having said this, the Company believes it is very important that the Division not place conditions in

requirement to only pay 10% and not 25% for restorations, a winter moratorium for gas customers, no shut offs for families with young children, and that the Company pay a merger benefit for the purposes of low-income people. 6/29/06 Tr. at pp. 66-67. Since these were raised for the first time at the hearing and not in their direct testimony, the Company did not specifically address these additional recommendations. Nevertheless, these issues are more appropriate for the Commission to deal with at a later date.

² Specifically, the Act creates R.I.G.L. § 39-2-1(e), containing specific restoration provisions and arrears forgiveness for low-income customers, as well as Title 42, Chapter 141 on Affordable Energy, which creates an affordable energy fund for the benefit of low-income customers.

the order on this issue out of context. There are many ways to manage bill consolidation that can take into account the concerns of low-income customers, while at the same time preserving options for the Company to operate its billing system and administer accounts in the most efficient manner. These issues need to be fully addressed by the Commission at a future time.

Finally, the Wiley Center's recommendation regarding dedicated supervisory call center staff for low-income customers is an inappropriate condition for this transaction. There is no evidence that the Company is not dealing properly with all of its customers on an emergency or any other basis. 6/29/06 Tr. at p. 84. Again, these are unbecoming conditions for the Division to place on this transaction, especially when the Company has committed to working with the Wiley Center in the future.

II. Benefits to Rhode Island

The benefits of the transaction are not limited to rate impacts. Narragansett has approached this transaction as a company that is committed to the energy delivery business and committed to the State of Rhode Island. The Company's core mission is to provide high-quality delivery service to its customers over the long term, consistent with the National Grid corporate vision of becoming the premier energy delivery company. The Company looks forward to expanding its business in the state and continuing its commitment to reliable, efficient service to customers. National Grid is experienced in the gas business. Over the years, the Company has demonstrated a strong commitment to act responsibly in the communities in which it serves, and has a strong track record in interacting with the government entities who have supervisory responsibility over the

Company in a very cooperative manner, including a high degree of integrity. These qualitative factors should also be taken into consideration in approving this transaction.

In fact, the Advocacy Section's witness stated, "National Grid has demonstrated experience in the operation of gas distribution utilities as well as in the operation of combined gas and electric utility operations. It also appears to have sufficient overall size and financial strength to ensure continued operation of both Rhode Island's gas and electric distribution systems. Moreover, over the past several years National Grid has shown itself to be capable of acquiring, effectively integrating, and safely operating other utility operations." Advocacy Section Exh. 1, at p. 28. The Advocacy Section also expressed no concern about a single company owning and operating both gas and electric distribution utility operations within the state, and that there are a number of utilities in the US that combine gas and electric utility distribution operations under a single ownership structure. Id. at p. 13.

III. The Tiverton Environmental Issue

At the outset of this proceeding, the Division appropriately narrowed the scope of this issue to a request for assurances "that the proposed asset sale does not negatively impact Southern Union's ability to pay for potential future remedial actions." Order No. 18591, at pp. 16, 17. With the evidence provided at the hearing, the record supports a Division finding that the proposed asset sale, in fact, does not negatively impact Southern Union's ability to pay for potential future remedial actions. The parties stipulated that an estimated cost range to clean up the Bay Street area was approximately \$30-\$55 million. Southern Union provided evidence from its filings with the U.S. Securities & Exchange

Commission that it has assets worth over \$7 billion, and a potential remedial cost in the \$30-\$55 million range would not be problematic for Southern Union to incur. 6/30/06 Tr. at pp. 193-94. In fact, Mr. Marshall, Treasurer of Southern Union, testified that Southern Union currently not only had over \$20 million in cash on the books, but that it had a revolving credit facility for \$400 million, with a balance of approximately \$200 million. Id. at pp. 195-97. Thus the evidentiary standard is met to support a finding that Southern Union would be financially capable of meeting a \$55 million clean up obligation even after their Rhode Island assets are sold. As such, there is no basis to deny the Petition based on the potential environmental liability relating to Tiverton.

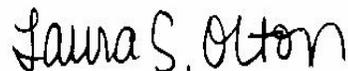
Conclusion

For all of the foregoing reasons, the Division should approve the Joint Petition.

Respectfully submitted,

**THE NARRAGANSETT ELECTRIC
COMPANY, d/b/a NATIONAL GRID**

By its Attorney,



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Dated: July 11, 2006

Certificate of Service

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



Joanne M. Scanlon

Date: July 11, 2006

National Grid & Southern Union - Docket D-06-13 Updated Service List as of 5/15/06

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