

June 23, 2006

VIA HAND DELIVERY & ELECTRONIC MAIL

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

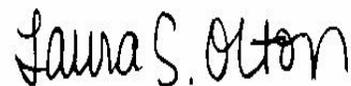
RE: Docket D-06-13 - Joint Petition of The Narragansett Electric Company and Southern Union Company for Approval of Purchase and Sale of Assets Rebuttal Testimony of Ronald T. Gerwatowski and Michael D. Laflamme

Dear Ms. Massaro:

On behalf of The Narragansett Electric Company, d/b/a National Grid, enclosed please find five (5) copies of rebuttal testimony of Ronald T. Gerwatowski and Michael D. Laflamme in response to the testimony of the Rhode Island Division of Public Utilities and Carriers Advocacy Section in the above-captioned proceeding.

Thank you for your attention to this matter. 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

REBUTTAL TESTIMONY

OF

RONALD T. GERWATOWSKI

IN RESPONSE TO THE ADVOCACY SECTION

I. Qualifications.

Q. Please state your name and business address.

A. Ronald T. Gerwatowski, 55 Bearfoot Road, Northborough, Massachusetts.

Q. Have you filed Direct Testimony in this Docket?

A. Yes.

Q. What is the purpose of this Rebuttal Testimony?

A. This Testimony is being provided in response to the Testimony filed by the Advocacy Section of the Division (“Advocacy Section”). Specifically, I am responding to the Testimony of Bruce R. Oliver and David J. Efron. In addition, Mr. Laflamme is providing Rebuttal Testimony to an issue raised by Mr. Efron regarding pension and PBOP expenses.

II. Response to Testimony of Bruce Oliver.

Q. What is the Company’s general response to the testimony of Mr. Oliver?

A. Overall, Mr. Oliver does not express any opposition to the approval of the Petition and indicates that the transaction has the potential to bring net benefits to customers. The Company agrees with that conclusion but, at the same time, we also believe the benefits

**Petition of The Narragansett Electric Company
and Southern Union Company**
Rhode Island Division of Public Utilities and Carriers
Docket D-06-13
Testimony of Ronald T. Gerwatowski
Page 2 of 11

are more than just a possibility. The premise for going forward with the transaction is 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 Electric. Such an agreement aligns the interests of the Company and its customers by establishing appropriate incentives to maximize savings. Our analysis has shown real savings and efficiencies to be gained through this transaction which will be permanently reflected in our cost of doing business over the long term.

Q. Mr. Oliver states that it is important that the transaction not adversely impact rates. What is the Company's response?

A. We agree. As I alluded to in my previous answer, the Company's consultant has performed a synergies savings analysis. Based on that analysis, we estimate the gross savings to the cost of service from the transaction would be \$1.6 million per year. In addition, there is expected gross savings that will flow to the electric side of the business estimated to be \$3.3 million annually. This means that gross annual savings is estimated to be \$4.9 million per year for Rhode Islanders. The Company also would propose treatment of the costs to achieve that would eliminate the concern identified by Mr. Oliver that the costs and savings should be synchronized in rates. This can be achieved by either amortizing the costs to achieve, including integration costs, over a reasonable

**Petition of The Narragansett Electric Company
and Southern Union Company**
Rhode Island Division of Public Utilities and Carriers
Docket D-06-13
Testimony of Ronald T. Gerwatowski
Page 3 of 11

period that assures that the savings will create annual net benefits, or employing a mechanism similar to what was used in the rate plan agreement when National Grid acquired EUA. Thus, while it is true that, at this stage, not all the details are available to make a precise calculation of the savings, we are confident that the delivery rates to gas customers will not be adversely affected once a new rate plan is put in place. In the meantime, National Grid will be honoring New England Gas's existing rate plan and proposes no changes in gas delivery rates until a new plan is approved, other than changes already permitted in the existing plan.

In light of these savings and the Commission's approval of our prior settlements that shared the savings from prior mergers in a way that protected customers from paying the costs of acquisition premiums, the transaction should not affect rates adversely, particularly when the rate effects are measured on the overall revenue requirements of the Company. As I have explained, the transaction will reduce the operating costs of New England Gas by \$1.6 million, and we will propose to share those savings with customers. Thus, measured as a whole, customers will be better off. Nevertheless, the accounting for the transaction will require adjustments to specific items on New England Gas' balance sheet. As we explain, these adjustments will be addressed directly in the rate plan so that the overall rates to customers are not adversely affected by the transaction.

Although the rate plan is not before the Division at this time, the Division should focus its consideration on the concrete economic benefits that are achievable through the cost savings produced by this transaction that could not be achieved if Southern Union did not sell the business to National Grid, in light of the Commission precedent that provides for a sharing of these savings with customers. When the test is employed in that context, there is no question that the transaction is in the interest of customers.

- Q. Mr. Oliver recommends that the Company extend the time for the filing of a new rate plan from six months to a period up to twelve months following the approval. How does the Company respond?
- A. The Company agrees that it makes sense to wait longer than six months and adopts the Division's suggestion to wait for a period that would be approximately twelve months from the Division's order.
- Q. Mr. Oliver suggests that the Company be required to include service quality standards in its new rate plan. How does the Company respond?
- A. The Company agrees with this suggestion and commits to include service quality standards in its future rate plan filing.

**Petition of The Narragansett Electric Company
and Southern Union Company**
Rhode Island Division of Public Utilities and Carriers
Docket D-06-13
Testimony of Ronald T. Gerwatowski
Page 5 of 11

Q. On page 19 of his testimony, Mr. Oliver notes that the response to Division Data Request 2-5(b) indicates uncertainty about whether the consolidation of meter reading functions will produce savings. Does the Company have more updated information from the integration process?

A. Yes. Since answering Division Data Request 2-5(b), the Company has learned that it is possible (with some technical modifications) to read both gas and electric AMR meters from one vehicle, where the gas company has installed AMR meters. Thus, we expect that savings should occur from consolidating the meter reading system.

Q. Mr. Oliver also notes uncertainty about consolidating information and billing systems. Would you like to clarify this?

A. Yes. It is important to distinguish between the consolidation of billing systems into one system at National Grid from the question of consolidating electric and gas bills into one bill. Regarding the former, we expect to have all billing systems consolidated by the last quarter of 2007. However, while the new billing system will be capable of consolidating electric and gas bills into one bill, the Company has not yet made a decision as to whether it will actually consolidate electric and gas bills in Rhode Island. These are two different matters that need to be distinguished.

Q. On page 28 of his testimony, Mr. Oliver states that Narragansett has made a pledge to offer continued employment to all existing New England Gas Company employees for at least one year. Would you like to clarify this?

A. Yes. It is important to understand that there are differences between union and non-union employees, as stated in the Company's response to Division Data Request 2-14. All employees covered by a collective bargaining agreement who meet the contractual requirement for job protection by date of hire and years of service will have their jobs protected in accordance with the terms of their applicable agreements. For employees not covered by a collective bargaining agreement, all these employees in Rhode Island will be offered a job with National Grid. Any employee who accepts an offer of employment, but is later terminated for reasons other than cause within one year, will be entitled to severance benefits, as specified in the Purchase and Sale Agreement.

III. Response to Testimony of David Effron.

Q. Mr. Effron raises three issues of concern in his Testimony. What are they?

A. The first issue relates to the acquisition premium. It appears that, through Mr. Effron's testimony, the Division is seeking assurance that the Company will not seek to recover the acquisition premium in rates. The second issue relates to PBOP and pension

expenses. The third issue relates to the revenue impact associated with the elimination of a deferred tax balance.

Q. What is the Company's response?

A. Each of these issues are items that relate to the future rate plan that will be under review by the Commission. Accordingly, these issues are not technically before the Division in this case. Nevertheless, the Company would like to respond to each of the three concerns raised by Mr. Effron.

Q. What is the Company's position with regard to the first issue -- the acquisition premium?

A. We do not believe this should be an issue. When National Grid made its offer to purchase the New England Gas assets and operations in Rhode Island, it was the Company's expectation that it would file a rate plan with the Commission that would be similar in structure to the rate plan currently in effect for Narragansett's electric operations. That plan provides the Company with a reasonable opportunity to recover some of the acquisition premium indirectly, through a mechanism that we commonly refer to as a shared savings plan. The shared savings plan is not an explicit recovery in the cost of service of acquisition premium. Under the plan, the Company and customers share in the benefits of any savings that can be achieved by the Company over a specified

period. This is not an entitlement to recover acquisition premium directly in rates and the Company does not claim that it is entitled to such direct recovery in Rhode Island. Instead, the plan depends on the ability of the Company to perform. Thus, it is an incentive mechanism, under which both the Company and customers benefit. We interpret Mr. Effron's testimony as expressing the Division's view that the Company should not be allowed direct recovery of the acquisition premium by recognizing goodwill for ratemaking purposes, but the Division does not object to the Company filing or negotiating a shared savings mechanism to be approved by the Commission. If this understanding is correct, then we are in agreement with the Division. The Company will not propose to recognize goodwill for ratemaking purposes, but rather will be seeking approval of a shared savings plan that allows the Company and customers to share in the cost savings benefits of the transaction, and in fact provides proper incentives to the Company to maximize such cost savings.

Q. What about the issue raised regarding PBOP and pension expenses?

A. The testimony of Mr. Laflamme addresses Mr. Effron's concern regarding this issue.

Q. What about the issue relating to deferred taxes?

A. We also do not believe this should be an issue. While the impact to deferred tax reserves

will give rise to an increase in the gas operations' revenue requirement, Narragansett commits that any rate plan filing to be made with the Rhode Island Public Utilities Commission would contain customer benefits in the form of cost savings and/or settlement credits that would more than offset this revenue requirement impact.

V. Concluding Comments

Q. Do you have any other general comments in response to the Advocacy Section?

Yes. As indicated here in my Rebuttal Testimony, the Company is committing to file a new rate plan proposal with the Commission within approximately twelve months from the date of the Division's order. The rate plan will consist of many parts. We expect many costs reflected for recovery through the rates will, on a side-by-side comparison to the expenses within the current New England Gas cost of service, be lower. At the same time, it also is possible that some expenses in the cost of service could be higher. When measured on a total company basis, the cost of providing service to customers will be lower than New England Gas Company's costs standing alone, absent the merger.

Measured using overall revenue requirements, there will be no adverse impact on rates from the transaction. Nevertheless, because of accounting adjustments following the transaction, specific items on New England Gas Company's balance sheet will be higher after the transaction than before. These effects will be addressed in the rate plan to assure that customers' rates are not adversely affected by the transaction. Thus, the rate

plan, measured as a whole, will be designed to produce benefits for customers through the allocation of synergy savings, which would not have been achievable had the transaction not occurred. These benefits can be passed along to customers through many different means. They can be reflected in lower rates, enhanced infrastructure programs, forms of settlement credits that assure stable delivery rates, or a combination of approaches. In the end, the Commission will review the plan proposed and determine whether such rate plan is just and reasonable in accordance with the precedent established in Narragansett's prior rate plans.

Q. Are there any qualitative factors that should be considered?

A. Yes. The benefits of the transaction are not limited to rate impacts. In that regard, National Grid 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 our 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. We also have demonstrated over the years a strong commitment to act responsibly in the communities

**Petition of The Narragansett Electric Company
and Southern Union Company**
Rhode Island Division of Public Utilities and Carriers
Docket D-06-13
Testimony of Ronald T. Gerwatowski
Page 11 of 11

in which we serve, and have 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.

Q. Does this complete your testimony?

A. Yes.

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
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IN RE: PETITION OF THE NARRAGANSETT)
ELECTRIC COMPANY AND SOUTHERN)
UNION COMPANY)

DOCKET NO. D-06-13

REBUTTAL TESTIMONY

OF

MICHAEL D. LAFLAMME

IN RESPONSE TO THE ADVOCACY SECTION

I. INTRODUCTION AND QUALIFICATIONS

Q. Please state your full name and business address.

A. My name is Michael D. Laflamme. My business address is 55 Bearfoot Road,
Northboro, Massachusetts 01532.

Q. By whom are you employed and in what position?

A. I am Manager of Regulatory Support for National Grid USA Service Company, Inc.
National Grid USA Service Company provides engineering, financial, administrative and
other technical support to subsidiary companies of National Grid USA, including The
Narragansett Electric Company (“Narragansett” or “Company”).

Q. Please provide a brief summary of your educational background and training.

A. In 1981, I earned a Bachelor of Science degree in Business Administration, emphasis in
Accounting, from Bryant College in Smithfield, Rhode Island.

Q. What is your professional background?

A. From 1981 through April 2000, I was employed by various subsidiary companies of
Eastern Utilities Associates (“EUA”), including Blackstone Valley Electric Company
(“Blackstone”) and EUA Service Corporation (“EUASC”) which provided various
accounting, financial, engineering, planning, data processing and other services to all
EUA System companies.

I joined Blackstone in 1981 as a junior accountant and attained a staff accountant position prior to transferring to the revenue requirements section of EUASC's Rate Department in 1985. I held progressively more responsible positions in revenue requirements prior to transferring to the Treasury Services department of EUASC in 1988. I was promoted to the position of Manager of Treasury Services in 1991. The EUA System was acquired by National Grid USA in early 2000, at which time I joined the National Grid USA Distribution Financial Analysis Group.

Q. What is your relationship to Narragansett?

A. My current duties include supporting cost of service and revenue requirements analyses for the National Grid USA distribution companies in New England, including Narragansett.

Q. Have you previously testified before a regulatory commission?

A. Yes, I have testified in proceedings before the Rhode Island Public Utilities Commission ("Commission"), the Massachusetts Department of Telecommunications and Energy and the New Hampshire Public Utilities Commission. I have also provided primary support for revenue requirements witnesses in proceedings before the Federal Energy Regulatory Commission.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. I am responding to the testimony of Division Witness David J. Effron with respect to his recommendations concerning Pension and PBOP expense post acquisition.

III. RESPONSE TO THE TESTIMONY OF DAVID J, EFFRON

Q. Do you have any general comment before responding directly to Mr. Effron's recommendations?

A. Yes. Ratemaking methodology is not a matter that is before the Division in this docket. All issues relating to the ratemaking treatment of expenses after the acquisition is a matter for the Commission. Moreover, we believe that Mr. Effron's issue, which is related to the recognition and amortization of the losses in NEGAs' pension and PBOP plans at the time of the closing will be easily addressed in the rate plan that we have proposed to file with the Commission in the event that the merger is approved and consummated. Simply stated, we are in agreement with Mr. Effron that the pension and PBOP losses should not be recovered from customers immediately, but rather offset by a regulatory asset. We are also in agreement that the regulatory asset should be amortized in a fashion that otherwise reasonably matches the pension and PBOP expense that would have been experienced absent the early recognition of the losses at the time of the closing. Mr. Effron's concern is simply a question of timing as all gains or losses produced in the pension and PBOP plans must eventually be recognized. However, we

will not have the numbers to work out the amortization schedule until we file the rate plan. At that time, we should be able to develop an amortization schedule that reasonably matches the estimated timing that would have been experienced for these losses absent the merger and the fair valuation that it creates.

Q. Would you please describe the Company's expected accounting treatment for any unrecognized losses in NEGas' Pension and PBOP plans at the time of merger?

A. Purchase accounting rules require that assets and liabilities be valued at fair value at the time of acquisition. At this time the net liability or surplus (liability less assets) would equal the opening balance sheet for each plan being acquired. As a result, all unrecognized gains or losses are recognized immediately at the closing, rather than over the life of the plans as they would normally be recognized. As Mr. Effron notes in his testimony (page 16) "rather than recognizing the increases in the liabilities over time through increased annual expense, the increases in the liabilities are recognized instantaneously at the time of the acquisition. This reduces the pension and PBOP expenses prospectively below what these expenses would be in the absence of the acquisition." Absent further action, these losses would be realized immediately.

Mr. Effron also recognizes that Narragansett does not propose to recover these losses in rates immediately, which would lead to an early year increase, followed by lower pension and PBOP recoveries in later years. Rather, Narragansett proposes to record a regulatory

asset to offset the loss, and then to amortize the regulatory asset over a period that reasonably matches the recognition of the expense, absent the merger. Mr. Effron agrees with this approach at his testimony on pages 16 and 17. As a result, Narragansett and Mr. Effron are in accord on the issue and the means to address the issue in the rate plan. Mr. Effron also suggests the method that could be used to develop the appropriate amortization stream. Specifically, he suggests that (Testimony pp. 18-19): “The pension expense pursuant to SFAS 87 and the PBOP expense pursuant to SFAS 106 should be calculated on a pro forma basis as if the balance sheet liabilities for pensions and PBOP had not been restated to their fair value at the time of the merger. That pro forma pension and PBOP expense should then be compared to actual test year pension and PBOP expense plus the amortization of the regulatory asset is included in operating expenses.” This approach can work in theory. However, in practice, it may present some difficulties that will need to be addressed. We should be able to address them reasonably in context of actual facts as we develop the rate plan, and through the proceedings associated with its review.

Q. What kind of practical issues will need to be addressed at that time?

A. We would like to determine the pattern of amortization at the outset in the rate plan, recognizing that the amortization will be based on a reasonable estimate of the stand alone and post-merger pension and PBOP expense streams. Moreover, we will need to use consistent assumptions and discount rates in both analyses. Following the

acquisition, we will change assumptions to match those used for Narragansett pension and PBOP plans. These assumptions will have to be consistently applied in any comparisons of pension and PBOP expenses before and after the merger. We will also have to address the affects of early retirement programs, if any are offered. Finally, we believe the approach that we have followed to amortize the regulatory liability associated with the gains in the New England Electric System and Eastern Utilities Associates pension and PBOP plans at the time of those mergers will provide a reasonable methodology for recognizing the losses in the NEGas pension and PBOP plans.

- Q. What methodology has the Company followed for amortizing the regulatory liabilities in its prior acquisitions?
- A. In the New England Electric System and EUA acquisitions, the Company followed the same accounting treatment being proposed in this transaction. In those transactions, however, the unrecognized amounts at the time of closing were gains and the Company therefore recorded a regulatory liability. The Company is amortizing that liability as a credit to Pensions and PBOP expense over the average remaining service lives of the participants in the NEES and EUA plans. By crediting the regulatory liability over the life of the plan, the amortization reasonably matches (though not exactly) the recognition of pension and PBOP losses that would have occurred absent the merger. The same amortization method can also be applied to amortize the regulatory assets recorded to offset the pension and PBOP losses in this case.

Q. Using this approach, over what period of time would the Company amortize the regulatory asset that will be recorded at closing in the NEGas transaction?

A. The Company would use the same period currently used to determine FAS 87 and FAS 106 expense. Specifically, this period is the average remaining service period of active employees expected to receive benefits under the plan.

Q. Does the Company expect to include the regulatory asset in rate base at the time of closing?

A. No, the Company would not include the regulatory asset in rate base at the time of closing the transaction. This regulatory asset would be a non-cash regulatory asset and should not be reflected in rate base.

Q. Does the Division have to decide this issue now?

A. No. The issue will best be evaluated by the Division and other parties in the context of the rate plan when we actually have the facts before us. If the method that we have used in prior cases is not reasonable in this transaction, we will be able to work with the facts known to produce an approach that does produce a reasonable result.

Q. Does the Company agree that this approach should be a condition for Division approval of the acquisition transaction?

A. No. This is a ratemaking issue that is not before the Division. Moreover, as stated in the testimony of Mr. Gerwatowski, the Company believes that the benefits of the acquisition should be valued in total rather than on an individual cost element basis. While a potential exists that pension and PBOP expense may be greater in any given year after the acquisition, the Company believes that the balance of benefits to be realized by customers as a result of this transaction will outweigh this potential near-term impact.

Q. Does that conclude your testimony?

A. Yes it does.

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: June 23, 2006

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

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