

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
DIVISION OF PUBLIC UTILITIES AND CARRIERS  
89 JEFFERSON BOULEVARD  
WARWICK, RHODE ISLAND 02888**

IN RE:       The Narragansett Electric Company       :  
              d/b/a National Grid, Application for       : Docket No. D-12-12  
              Authority to Issue Long-Term Debt        :

**REPORT AND ORDER**

On April 26, 2012, the Narragansett Electric Company, d/b/a/ National Grid (“National Grid,” or “Company”) filed an application with the Rhode Island Division of Public Utilities and Carriers (“Division”) seeking Division authorization to issue and sell one or more series and/or issues of new long-term debt.<sup>1</sup> The application was filed in accordance with the requirements contained in Section 39-3-15 of the Rhode Island General Laws and Rule 14 of the Division’s *Rules of Practice and Procedure*.

According to the application, National Grid specifically seeks Division authorization to:

- (a) Issue, from time to time, through March 31, 2014, new long term debt not to exceed an aggregate principal amount of \$250 million outstanding at any one time for the purpose of: (i) refinancing short-term debt, (ii) refinancing maturing and/or redeemed issues of debt (including, without limitation, previously redeemed issues), (iii)

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<sup>1</sup> National Grid Exhibit 1.

financing the capital needs of the Company, or (iv) for other general corporate purposes;

- (b) Issue long-term debt with a maturity greater than one year and not to exceed 40 years from the date of issuance. The securities would carry either a fixed rate or adjustable interest rate, which will vary with market index to be designated at the time of issuance, not to exceed an effective rate of 11 percent per annum (the "Maximum Interest Rate"). To ensure adequate flexibility in meeting market conditions at the time of issuance, the Company is requesting authorization to issue secured or unsecured debt, taxable or tax-exempt debt, bonds, medium or long term notes, debentures, revolving credit loans and term or bank loans, or similar securities (i.e., the "New Debt"); and
- (c) Enter into evidences of indebtedness and related instruments in connection with New Debt, including, but not limited to, loan agreements, indentures, supplemental indentures, promissory notes, debentures, credit agreements, participation agreements, underwriting or similar agreements, bond purchase agreements, remarketing agreements, security agreements and instruments insurance agreements, or their equivalent, and amendments, restatements, modifications, or supplements thereto ("Instruments"). The terms of each Instrument will be substantially similar to the terms for comparable transactions available in the credit market, at

the time of New Debt issuance, to companies having a credit rating substantially equivalent to the Company's credit rating.<sup>2</sup>

The application further provides the following information and requests regarding the proposed issuance and/or sale of long-term debt:

- The New Debt may be issued to or through third parties, in either public offerings or private placements. Publicly offered New Debt may include, without limitation, New Debt registered with the Securities and Exchange Commission and New Debt listed on the New York or other Stock Exchange with or without an associated guaranty by a direct or indirect parent of the Company.
- The owners of New Debt issued to or through third parties may have the right to tender the New Debt for the purchase upon specified notice periods. The New Debt may be subject to redemption at the option of the Company in accordance with the terms of the applicable agreement and otherwise as required by such agreement.
- As of December 31, 2012, the Company has approximately \$604.3 million of long-term debt and \$168.9 million of short-term debt outstanding. The Company may refinance the short-term debt with New Debt depending upon market conditions and the terms of such debt.

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<sup>2</sup> National Grid Exhibit 1, pp. 1-3.

- In determining the timing and amount of issuance of the New Debt, the Company intends to maintain a ratio of total long-term debt to total capitalization (excluding goodwill) of approximately 50 percent.
- Because of volatility in the debt markets, it is in the public interest that the Company have the flexibility to choose the timing of and to select purchasers of the long term debt securities on the basis of standards and criteria that in management's judgment will result in benefits to the Company and its customers, including, but not limited to, the terms and interest rate. Because the precise terms of the proposed New Debt issuances are not known at this time, the Company seeks a waiver of the Division's Rules of Practice and Procedure 14 (1) (ii), (iii) and (iv) [sic] to the extent that it would require the Company to provide investment memoranda, prospectuses, information or registration statements or other documents to describe the transactions or potential funding sources.
- The Company requests that the actual costs and expenses of issuing New Debt be deferred and amortized over the life of the New Debt.<sup>3</sup>
- The Company currently plans to begin issuing New Debt in the fall of 2012. The Company requests that the Division act on this

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<sup>3</sup> Exhibit B to National Grid Exhibit 1 contains the Company's current estimate of the costs and expenses of issuing New Debt.

Application expeditiously to enable the Company to plan the issuance of New Debt in accordance with its current schedule.

- Exhibit C to the Company's application comprises the actual balance sheet of the Company at December 31, 2011.<sup>4</sup>
- National Grid also proffered the pre-filed testimony of Ms. Lorraine M. Lynch, Vice President and Treasurer of the Narragansett Electric Company, in support of its application filing.<sup>5</sup>

In response to the application filing, the Division conducted a duly noticed public hearing on October 31, 2012.<sup>6</sup> The hearing was conducted in the Division's hearing room, located at 89 Jefferson Boulevard in Warwick. The following counsel entered appearances:

For National Grid:	Thomas R. Teehan, Esq.
For the Division's Advocacy Section ("Advocacy Section"):	Leo J. Wold, Esq. Assistant Attorney General

### **Settlement Agreement**

On October 15, 2012, the Company and the Division's Advocacy Section submitted an executed "Settlement Agreement" in this docket.<sup>7</sup> That agreement has been attached to this Report and Order, and is hereby incorporated by reference.

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<sup>4</sup> National Grid Exhibit 1, pp. 3-5.

<sup>5</sup> National Grid Exhibit 1, "Exhibit A."

<sup>6</sup> A hearing on the instant application was delayed, at the request of the parties, in order to facilitate discovery and settlement discussions between the parties. The October 31, 2012 hearing was scheduled and conducted after a stipulated agreement was received from the parties on October 15, 2012, infra.

<sup>7</sup> Joint Exhibit 1.

### **Advocacy Section's Position**

In addition to the executed Settlement Agreement, the Advocacy Section also proffered the pre-filed testimony of Matthew I. Kahal, a consultant and expert witness specializing in utility ratemaking and policy issues.<sup>8</sup> Mr. Kahal's business address is 10480 Little Patuxent Parkway, Suite 300, Columbia, Maryland 21044.

Mr. Kahal testified that after he conducted an initial review of National Grid's application filing, he prepared a set of data requests to obtain further information and to explore certain issues. He related that after he had an opportunity to review the Company's discovery responses, he developed "an issues list of concerns," which led to a telephonically conducted technical conference and subsequent discussions between members of the Company and the Division's Advocacy Section staff. Mr. Kahal testified that these discussions culminated in the Settlement Agreement now before the Division for approval.<sup>9</sup>

Mr. Kahal related that before reaching an agreement with the Company, he was concerned with the overall lack of specificity in the application. Specifically, he noted that National Grid's application requests authority to issue \$250 million over the next two years, but does not provide a planned schedule for doing so. Mr. Kahal observed that the application also requests authority for a very wide range of types of debt that would be issued, methods of issuance and debt structure, and that the application requests authority to

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<sup>8</sup> Advocacy Section Exhibit 1.

<sup>9</sup> Id., p. 5.

incur interest rates as high as 11 percent. Regarding this lack of specificity, while Mr. Kahal agrees that the Company needs some flexibility to respond to the “dynamic nature of financial markets,” he believed that the request “needed to be clarified and to some degree narrowed.”<sup>10</sup> Mr. Kahal testified that the Settlement Agreement “adequately and appropriately balances the Company’s need for flexibility with the Division’s need for specificity and oversight.”<sup>11</sup>

Mr. Kahal next discussed the flexibility that the Company is seeking with regard to how it will conduct the planned debt issuance(s) and the characteristics of the bonds to be issued. He explained that during the discovery phase of this case the Company provided the following information:

- The Company intends to issue the new debt as unsecured. This appears to be based on its determination that cost savings from issuing secured debt would be relatively small.
- While the original request for issuance authority extends to March 31, 2014, the Company intends (if feasible) to complete the up to \$250 million issuance by the end of this year.
- The Company expects the issuance to take place in the form of one or more private placements. The private placement market is both robust and attractive and this will help to minimize costs of issuance.
- While final decisions have not been made, the Company initially stated that it does not anticipate the use of a Treasury lock to hedge (or partially hedge) the interest rate. The Company made use of such a hedging instrument in connections with its 2010 issuances.

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<sup>10</sup> *Id.*, pp. 5-6.

<sup>11</sup> *Id.*, p. 6.

- The Company originally stated that it was not amenable to the “credit spread” limitation (i.e., 350 basis points above the U.S. Treasury yield benchmark) that it agreed to for its 2010 debt issuance.<sup>12</sup>

Mr. Kahal agreed that is it appropriate for the Company to engage in a large long-term debt issuance in order to reduce its short-term debt. He acknowledged that short-term debt is presently very inexpensive, but testified that “it can at times be volatile.” Mr. Kahal cautioned that “while it is appropriate for the Company to employ short-term debt as a financing tool, it should not become chronically over dependent on its use.”<sup>13</sup>

Mr. Kahal opined that the proposed issuance will not eliminate the Company’s need for short-term debt financing in the future. He stated that assuming that most (or all) of the \$250 million in long-term proceeds are used to extinguish the current short-term debt balance, the Company’s short-term debt would decline to a very low level. However, Mr. Kahal observed that “this effect likely would be temporary.” He opined that over time, the Company would continue to use short-term debt to fund ongoing construction and for other purposes.<sup>14</sup>

Mr. Kahal next offered a description of the Settlement Agreement and the reasons why he supports it. He began by explaining that the Settlement Agreement authorizes new debt issuances of up to \$250 million for the

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<sup>12</sup> *Id.*, pp. 7-8.

<sup>13</sup> *Id.*, pp. 8-9.

<sup>14</sup> *Id.*, p. 9.

purposes specified in the Company's application. He noted that the proceeds may not be used for unregulated activities or for loans to affiliates.<sup>15</sup>

Mr. Kahal testified that the Settlement Agreement states that the Company intends to proceed with the new debt issuance 'as soon as reasonably practicable' after the issuance of a non-appealable order by the Division approving this Settlement Agreement. He related that with such approval, the Company shall make reasonable efforts to close on the issuance by December 2012. Mr. Kahal also noted that the Settlement Agreement is less open ended than the application with respect to timing, requiring the Company to now issue this debt by May 31, 2013, instead of by the March 31, 2014 date indicated in the application filing.

Mr. Kahal next explained that under the Settlement Agreement the Company is permitted the use of hedging as a tool to protect customers from rising interest rates while the debt issue is pending, but it does not compel its use. He explained that if the Company contemplates doing so, it must consult with the Division's Advocacy Section before engaging in hedging.<sup>16</sup>

Mr. Kahal next testified that the Settlement Agreement does not accept the 11 percent borrowing rate cap that is contained in the Company's application. Instead, he explains that the Settlement Agreement "limits the maximum interest rate on the Initial Issuances to the corresponding Treasury yield plus 350 basis points. Mr. Kahal related that since 30-year Treasury yields are presently about 3.0 percent, the Settlement Agreement would limit

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<sup>15</sup> *Id.*, p. 10.

<sup>16</sup> *Id.*, pp. 10-11.

National Grid's "interest rate on a 30-year debt issue at this time to 6.5 percent."<sup>17</sup>

Mr. Kahal additionally testified that the Settlement Agreement compels the Company to use the debt issue proceeds for utility purposes. He emphasized that National Grid may not lend any such funds on a long-term basis to its corporate affiliates or use the proceeds for non-regulated activities.<sup>18</sup> He noted however, that the agreement does not restrict the Company from full participation in a National Grid utility money pool for short-term borrowings and loans.<sup>19</sup>

Mr. Kahal also explained that the Settlement Agreement identifies a term of from one to 30 years and in one or multiple tranches for the \$250 million. He also noted that the Company has expressed a preference for a term toward the upper end of that range. Given today's extraordinary low interest rate environment and investor demand for 30-year utility debt, Mr. Kahal agreed with the Company's preference.<sup>20</sup>

Mr. Kahal also testified that the Settlement Agreement does not pre-approve or support any cost recovery for costs that the Company will incur associated with the new debt. He related that the Settlement Agreement explicitly states that in approving the Initial Issuance neither the Division or its Advocacy Section necessarily concurs with the Company's capital spending plan, its proposed capital structure in the pending rate case (or in any future

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<sup>17</sup> Id., p. 11.

<sup>18</sup> Id.

<sup>19</sup> Id.

<sup>20</sup> Id., p. 12.

rate case) or the valuation of Company assets. Mr. Kahal added that the Settlement Agreement also contains an acknowledgment from the Company of its “affirmative obligation” to undertake the Initial Issuance at lowest reasonable cost, and to employ “a prudent mix of capital.”<sup>21</sup> Mr. Kahal also stated that while this Settlement Agreement does not pre-approve either Commission ratemaking or accounting treatments relating to debt issuances, it does set forth the Division’s Advocacy Section’s opinion that such costs should be eligible for rate recovery, subject to prudence, reasonableness and appropriate allocations.<sup>22</sup>

Mr. Kahal next testified that the Settlement Agreement also includes a provision that grants the Company’s request for a waiver of the filing requirements contained in Rule 14(1)(ii),(iii) and (iv) of the Division’s *Rules of Practice and Procedure*.<sup>23</sup> Mr. Kahal agreed that in order to respond effectively to market conditions, the Company is not able to prepare and submit the issuance-related documents in advance of undertaking the issuances (as prescribed under the Division’s Rules). Accordingly, he opined that the Company’s request for such a waiver in this case is reasonable. Mr. Kahal testified, however, that the Company will alternatively be required, under the Settlement Agreement, to submit those documents within 45 days of the debt issuance transactions closing, including a statement of final costs. He related

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<sup>21</sup> *Id.*, pp. 12-13.

<sup>22</sup> *Id.*, p. 13.

<sup>23</sup> It should be noted that both the Company and the Advocacy Section have inaccurately cited the applicable provisions of Rule 14 of the Division’s Rules of Practice and Procedure. The correct citation is Rule 14(a)(1)(ii),(iii) and (iv) and not Rule 14(1)(ii),(iii) and (iv).

that the Settlement Agreement will also require the Company to inform the Division of the basic terms for each issuance within five days of issuance; and to provide the Division with informal advance notification of its intent to issue shortly before such issuance takes place.<sup>24</sup>

In his concluding comments, Mr. Kahal delineated the following summarized reasons for why he believes the Settlement Agreement is in the public interest:

- It provides the Division with more effective oversight by authorizing approval of the full Initial Issuance of \$250 million and requiring that this be completed no later than May 31, 2013. Moreover, the Company must make reasonable efforts to complete it by December 2012.
- Given today's very favorable debt market conditions, this prompt issuance requirement is important for customers. In addition and if needed it allows for possible use of a Treasury lock to hedge near-term changes in debt market conditions.
- It sets the maximum allowable interest rate at a reasonable level in a form of a credit spread.
- It provides the Company the waiver that it needs for the advanced filing of documents, while ensuring the Division will be fully informed and receive the required documents on a timely basis.
- It allows the use of a wide range of debt instruments but restricts to some degree the use of hedges and derivatives to those that are potentially beneficial.
- The Settlement Agreement makes clear that any Division order would not provide pre-approval of cost recovery of debt expenses or endorsement with

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<sup>24</sup> *Id.*, pp. 13-14.

any capital structure or capital spending plan. At the same time it affirms the Company's obligation to issue debt at lowest reasonable cost and use a prudent mix of capital.<sup>25</sup>

After listing the aforementioned reasons, Mr. Kahal opined that it would be prudent and beneficial for the Company to proceed with a debt issuance at this time as large as \$250 million to help fund capital spending and effectively manage its capital structure. He further opined that the Settlement Agreement is in the public interest and should be approved as filed.<sup>26</sup>

#### FINDINGS

Initially, pursuant to the requirements prescribed in Rule 27 (b)(5) of the Division's Rules of Practice and Procedure, the Division finds the Settlement Agreement offered by the parties in this docket to be just, fair and reasonable, in the public interest, and in accordance with Rhode Island law and regulatory policy. As such, the Division has decided to accept the Settlement Agreement offered in this docket.

Predicated on a careful examination of the record in this matter, the Division finds National Grid's application, as modified by the Settlement Agreement accepted and approved herein, to be reasonable and in the best interest of National Grid and its ratepayers. The Division additionally finds that National Grid has met the requisite burden of proof set forth in R.I.G.L. §39-3-15, et seq. and that the proposed application for securities issuance is in the public interest.

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<sup>25</sup> Id., pp. 14-15.

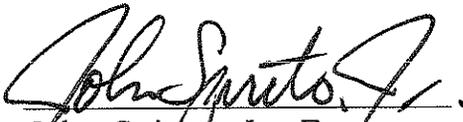
<sup>26</sup> Id., p. 15.

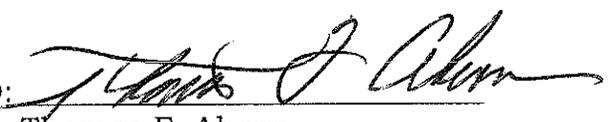
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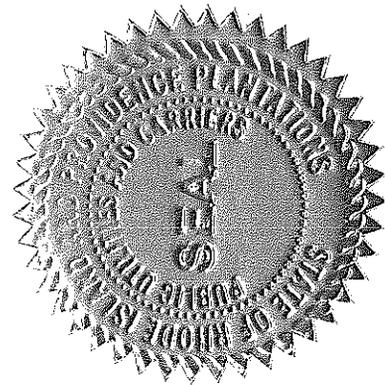
(20853) ORDERED:

1. That the October 15, 2012 Settlement Agreement attached and incorporated by reference to this Report and Order is hereby approved and accepted, in toto.
2. That National Grid's April 26, 2012 application, as modified by the Settlement Agreement approved herein is hereby granted.

DATED AND EFFECTIVE AT WARWICK, RHODE ISLAND ON OCTOBER 31, 2012.

  
John Spirito, Jr., Esq.  
Hearing Officer

APPROVED:   
Thomas F. Ahern  
Administrator





The foregoing shall not limit the Company from fully participating in the current and in any future National Grid Money Pool arrangements in which regulated affiliates of the Company also participate, including, without limitation, making short-term loans (i.e., for a term not exceeding one year) in connection with such arrangements.

2. The Initial Issuance(s) will be effected in one or more tranches with maturity dates each greater than one year but not to exceed 30 years from the date of issuance.
3. The Division Advocacy Section recognizes that issuing in multiple tranches as opposed to a single larger issuance is a reasonable way to diversify the Company's long-term debt outstanding, but that such an issuance strategy may increase the credit spreads associated with such issuance.
4. The Company may enter into evidence of indebtedness for the new long-term debt through any or all of the instruments set forth in the Company's Application dated April 26, 2012, except that the Initial Issuance(s) will be unsecured fixed interest rate debt.
5. The Company will inform the Division Advocacy Section of its intent to issue in advance of closing. However, such advance notification shall not be a condition precedent to the Company's right to proceed with an issuance otherwise authorized by the Division of Public Utilities and Carriers (the "Division") in this docket.
6. The maximum interest rate for any new debt issued pursuant to an Initial Issuance shall not exceed the U.S. Treasury rate for similar maturities at the time of pricing plus 350 basis points.
7. The Company's use of hedging instruments related to the Initial Issuance(s), while not compulsory, shall be limited to cross currency swaps, interest rate swaps, Treasury locks, forward rate swaps and call provisions. If the Company does make use of a hedging instrument, it will consult with the Division Advocacy Staff before doing so.
8. For accounting purposes, the Company will be permitted to defer and amortize all the reasonable and prudent costs and expenses of the Initial Issuance(s), including debt discount or premium over the life of this new long-term debt. The Division Advocacy Staff recognizes that debt issuance costs, including hedging costs (or credits), should be eligible for rate recovery to the extent such costs are reasonable, prudently-incurred and appropriately allocated to retail gas and electric utility service.

9. The Company's request for a waiver of the Division's Rules of Practice and Procedure 14(1)(ii), (iii) and (iv) shall be granted and the Company shall provide the Division with a statement of the basic terms of each issue within 5 days following the settlement of the Initial Issuances. A copy of the executed debt transaction documents along with a statement of the final actual costs shall be provided to the Division within 45 days following the settlement of each tranche of the Initial Issuances.
10. Any Order by the Division approving this Initial Issuance(s) shall not constitute approval of or the Division's or the Division Advocacy Section's concurrence with:
  - a. The Company's capital spending plan;
  - b. The capital structure proposed by the Company in R.I.P.U.C. Docket No. 4323 or in any future docket;
  - c. The value of any assets, tangible or intangible, owned or to be owned by the Company.
11. An Order by the Division approving this Initial Issuance(s) shall not constitute pre-approval of or concurrence by the Division or the Division Advocacy Section of any specific amount of expenses incurred by the Company for cost recovery or ratemaking purposes.
12. The Company retains an obligation to conduct its Initial Issuance(s) at the lowest reasonable cost for the benefit of its retail customers.
13. This Settlement Agreement shall not affect or limit in any way the position and/or authority of the Division or the Rhode Island Public Utilities Commission with respect to rates, services, financial policies, accounting or any other matter affecting the Company.
14. The Company retains an obligation to use a prudent mix of capital to finance its utility operations and investments.
15. As soon as reasonably practicable following receipt of a final non-appealable order of the Division approving this Settlement Agreement in the form and substance presented herein, the Company shall make reasonable efforts to conduct and close the Initial Issuance(s) in accordance with the terms of this Settlement Agreement and at the lowest reasonable cost for the benefit of its retail customers by December 2012. In any event, the Company's authority to issue up to \$250 million in long term debt under this Settlement does not extend beyond May 31, 2013. Any treasury lock entered into after consultation with the Division Advocacy Staff will be cash settled as close in time as practicable to the pricing of the new debt issue being hedged. The cash settlement amount of hedging instruments will not be considered as part of the maximum interest rate restriction referred to in Paragraph 6 above.

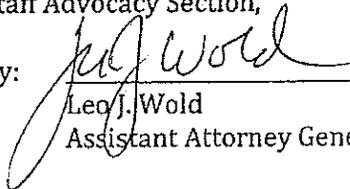
16. All prior discussions and agreements with respect to the subject matter hereof are merged in this Settlement Agreement, which alone constitutes the entire agreement between the Parties as to its subject matter. This Settlement Agreement may not be amended, modified or terminated except by a written agreement signed by both Parties, which specifically references this Settlement Agreement. This Settlement Agreement is submitted on the condition that it be approved in its entirety by the Division after hearing, and on the further condition that if the Division does not approve this Settlement Agreement in its entirety, the settlement shall be deemed withdrawn and shall not constitute a part of the record in this proceeding or be used for any purpose, unless all Parties agree to Division modifications.

17. This Settlement Agreement may be signed in counterparts each of which shall be deemed an original and all of which together shall constitute one in the same document.

The Narragansett Electric Company  
d/b/a National Grid:

By:   
Lorraine M. Lynch  
Assistant Treasurer

The Division of Public Utilities and Carriers  
Staff Advocacy Section,

By:   
Leo J. Wold  
Assistant Attorney General