STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

EnergyNorth Natural Gas, Inc. d/b/a National Grid NH

Docket DG 10-017

Direct Testimony
of
Nickolas Stavropoulos

February 26, 2010

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I. INTRODUCTION AND QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Nickolas Stavropoulos. My business address is 40 Sylvan Road, Waltham, MA 02451.

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

A. I am the Executive Vice President of Gas Distribution-US for National Grid USA ("National Grid") with responsibility for National Grid's regulated gas distribution operations in New Hampshire, Massachusetts, Rhode Island, and New York. I am also the President and Chief Operating Officer of EnergyNorth Natural Gas, Inc. d/b/a National Grid NH ("National Grid NH" or the "Company").

Q. Please briefly describe your educational background and your business experience.

A. I graduated from Bentley College in 1979 with a Bachelor of Science in Accounting. Subsequently, I earned a Masters of Business Administration from Babson College. I joined Colonial Gas Company ("Colonial") in 1979 as an analyst in the rates and accounting areas. In 1985, I was named Vice President of Rates and Planning and, over the next ten years, held a series of senior positions with Colonial, including Chief Financial Officer. In 1995, I assumed responsibility for all of Colonial's financial, marketing, information technology, and customer service functions as Executive Vice President of Finance and Marketing in addition to my position as Chief Financial Officer. Following the acquisition of Colonial by Eastern Enterprises ("Eastern") in 1999, I was named Senior Vice President of Marketing and Gas Resources for Eastern's regulated gas distribution companies. When KeySpan Corporation ("KeySpan") acquired Eastern in 2000, I was named KeySpan's Senior Vice President of Sales and Marketing for New England. I was subsequently named Executive Vice President of KeySpan and Head of KeySpan New England Gas Operations in 2002 and then President of KeySpan Energy Delivery with the responsibility for KeySpan's 2.6 million natural gas customers in New Hampshire, Massachusetts, and New York in 2004. Following the National Grid acquisition of KeySpan, I was named to my current position. I am currently the Second Vice President of the American Gas Association ("AGA") and former Chairman of the Board of Directors of the Northeast Gas Association.

Q. What are your principal responsibilities?

A. As Executive Vice President of Gas Distribution—US, I am the senior officer responsible for safe and reliable operation of National Grid's gas distribution system. This system, which consists of over 35,000 miles of distribution and transmission main, serves approximately 3.5 million customers throughout New England and New York, making National Grid the largest distributor of natural gas in the northeastern U.S. I am responsible for overseeing approximately 5,500 employees in New England and New York who perform all of the field work for maintenance, construction, and operation of the gas distribution system, as well as the Network Strategies group, which encompasses engineering, reliability, and integrity planning. I also oversee the Company's LNG operations and the support functions associated with gas operations.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe the factors motivating the Company's filing of a new general base rate case at this time and how the Company's proposals in this proceeding are designed to address these factors while simultaneously furthering the interests of our customers, the communities we serve, regulators and other state policy makers, and the environment.

II. <u>FACTORS MOTIVATING THE COMPANY'S FILING</u>

Q. Why is the Company filing a rate case at this time?

A. I recognize that the Commission is likely to be disappointed to have to review the Company's base rates again so soon after having conducted a full rate case. I share that disappointment.

As the Commission is aware, the Company's last rate case (DG 08-009) was filed on February 24, 2008, the Commission issued its decision determining final base rates on May 29, 2009, and it issued its order on the Company's request for reconsideration on November 13, 2009. However, the rates set in DG 08-099 are already insufficient to produce enough revenue to provide the Company with adequate and timely recovery of the costs associated with providing safe, reliable, and efficient service to its customers. In fact, as our filing will demonstrate, the rates were insufficient to allow the Company to earn the return authorized by the Commission even for the year during which the case itself was pending.

After we concluded the last rate case, we took a close look at the order and considered what the Company's next step should be. We decided that it was in the best interest of the Company and its customers to come back to the Commission and explain why the Company has not been able to earn the return authorized by the Commission and why this problem will continue to occur unless the Commission modifies its traditional rate-setting processes to address the real challenges facing utilities in today's operational and economic environment. This problem—the inability to earn the return established by the Commission—is a critical concern that the Company hopes to address in this case through its proposed modifications to the Commission's traditional method of setting distribution rates.

The Company's proposals go beyond the difference between the Company's view and the determination of the Commission in the last rate case as to what the proper allowed rate of return should be. As Dr. Susan Tierney, a former utilities regulator herself, explains in her testimony on behalf of the Company, because of a number of differences between the environment in which the Company provides service today versus the environment in which it historically operated, it will be mathematically impossible for the Company to earn *whatever* return on equity ("ROE") the Commission authorizes unless the Commission adjusts some of its traditional ratemaking methodologies. Failure to address this situation is undermining, and will continue to undermine not only the Company's financial well-being but also its ability to make investments that improve the reliability and integrity of its gas distribution system and enable the Company to achieve its goal of delivering unparalleled safe, reliable, and efficient service to its customers.

Q. You said there are a number of differences between the environment in which the Company provides service today as compared to the environment in which it historically operated. Please explain what factors in today's environment are causing the Company to need rate relief so soon after its last rate case.

A. Several significant factors have contributed to the Company's need to file another rate case at this time, including (1) minimal customer growth and essentially flat natural gas usage per customer, (2) the fact that a majority of the Company's capital investment is not related to growth in throughput but rather is required to repair and replace portions of the Company's aging distribution system, and (3) the fact that several major categories of costs that tend to be quite volatile have risen substantially. I will briefly discuss each of these forces in my testimony, although they are addressed in more detail by other witnesses.

Q. What rate relief is the Company requesting in this proceeding?

A. In this proceeding, the Company is seeking a rate increase to recover an annual revenue deficiency of approximately $11,422,718 based on a proposed return on equity of 11.2% on a rate base of approximately $169,006,099. The Company's proposal represents an average increase of approximately 10% on the total bill for the average residential heating customer.

Q. Earlier, you indicated that there are several cost categories that have risen significantly and that tend to be volatile. Can you explain what those are?

A. The three most significant ones are the Company's expense for pensions and other post-retirement benefit plans (referred to as "OPEBs"), uncollectible accounts expense (sometimes referred to as bad debt), and property taxes. With regard to the first two, I am aware that there has been a significant difference between the Company and the Commission staff regarding how these two expense categories should be addressed in the ratemaking context. Nevertheless, both are major cost drivers for the Company that have the ability to significantly and adversely impact earnings. For the Company to be financially healthy, it is critical that these costs be fully recovered through the Company's rates.

With regard to property taxes, while this cost has always been an area of concern for the Company and utility regulators, more recently it has begun to rise at a significant rate. As Mr. Lombardo and Mr. Adams explain in their testimony, in order for the Company to have a reasonable opportunity to earn its allowed return, one adjustment that needs to be made to the Company's revenue requirement is to ensure the most recent level of property taxes that the Company is obligated to pay is fully reflected in rates. To accomplish this, the Company plans to update this expense later in the case when the taxing authorities issue their updated tax bills.

As for pension and OPEB expense, as the Commission is aware, these costs are determined in accordance with complex accounting and federal regulatory requirements and have become quite volatile in recent years. The Company strongly believes that it is time for these costs to be addressed through a reconciling mechanism, rather than in a more traditional fashion. The Company's proposal will allow the Company to recover these costs as they vary from year to year, while benefiting customers by ensuring that the Company only recovers the actual cost it must accrue and no more. Mr. Lombardo and Mr. Adams will address this issue in more detail as well.

Finally, the Company's uncollectible accounts expense has also risen substantially in recent years. Tracey McCarthy, Vice President for Customer Financial Services, will discuss the forces that are resulting in this increase as well as the increased efforts that the Company has undertaken to mitigate it. This is another expense where the Company believes that a change is required in how it is recovered through rates. With regard to the commodity-related portion of uncollectible accounts expense, the current method of recovery is inconsistent with the fact that the Company has no opportunity to earn a profit on commodity sales and, therefore, should not be at risk for non-collection of commodity-related revenues. The Company has sufficient incentive to pursue collection of its bills because it is fully at risk for the delivery portion of the bill. To address this risk/benefit inconsistency, the Company will be proposing that it be permitted to recover the commodity-related portion of its uncollectible accounts expense on a fully reconciling basis, something that will benefit both customers and the Company as the uncollectibles rate rises and falls over time. The Company's affiliate, Granite State Electric Company, already has such a mechanism, and the core policy considerations that support full reconciliation on the electric side apply on the gas side as well.

Q. What is National Grid's goal with regard to the rates being established in this case?

A. National Grid needs to operate within a regulatory environment and a ratemaking framework that provides a meaningful opportunity for the Company to earn its allowed return, which requires that the Company be able to recover its prudently incurred ongoing operating costs as well as its prudently incurred costs associated with increases in its capital investment. Otherwise, there will be a continual cycle of rate cases, followed by sub-par earnings, followed by rate cases. A company that cannot earn its allowed return, no matter how many times it files rate cases, is simply an unattractive investment and, in addition to the long term impact on its ability to attract equity capital, is likely to face higher borrowing costs when it attempts to issue long term debt, resulting in higher rates for customers.

While it is imperative that the Company continue to evolve to meet the changing expectations of regulators and customers, it is equally imperative for ratemaking policies to evolve in a manner that recognizes these changes and provides a real opportunity for the Company to maintain its financial health while providing safe and reliable service to the public.

Q. Why doesn't the rate relief from the last rate case provide the Company with adequate cost recovery and a reasonable opportunity to earn a fair return on its investment?

A. The core reason is the regulatory lag that is inherent in the historic cost-of-service ratemaking model in New Hampshire. In former times, increasing revenues from customer growth were sufficient to cover the cost of the additional investment and rising operating costs that might be incurred in the immediate period after the Commission established new rates. Because of the need for the Company to continue to invest in its distribution system on an ongoing basis, however, when revenues are flat or declining it is mathematically impossible for the Company to earn its allowed return unless the Company can substantially reduce its operating costs. Even if the Company can achieve some cost savings despite doing business in a rising cost environment, such an approach is not sustainable in the long run.

Q. Is the Company making any proposals to address the regulatory lag issue?

A. Yes. As described in more detail in the testimony of Dr. Tierney, the Company is asking the Commission to expand the current cast iron/bare steel (referred to as "CIBS") rate adjustment mechanism to include public works-related capital investment in order to provide for more timely recovery of these investments as well as covering all CIBS capital costs and not just those over the first $500,000. In addition, consistent with what I understand has been recent Commission practice, the Company proposes to update operating expenses to reflect on an annualized basis any known and measurable changes that occur during the twelve-month period following the end of the test year (*i.e.*, through June 30, 2010). As noted above, the Company is also proposing that expenses related to pension and OPEBs and commodity-related uncollectible accounts be reconciled on a going-forward basis. Finally, the Company is proposing to adjust rates periodically to reflect the impact of inflation (net of a productivity adjustment) on operating expenses. If the Company is to have a meaningful opportunity to earn its authorized return, it will be necessary to set rates that reflect the Company's actual level of investment and operating costs.

Q. You stated above that there are several factors motivating the Company to file a new rate case so soon after it completed its last rate case. Other than the expense factors that you described earlier, please describe the other factors that you indicated are motivating the Company to file a new rate case at this time.

A. As I briefly mentioned above and as Ms. Fleck and Dr. Tierney discuss in their testimonies, minimal customer growth and essentially flat natural gas usage per customer both represent significant challenges to the Company's ability to operate profitably in New Hampshire. In fact, over the period 2002-2008, on a weather normalized basis, annual gas consumption by a typical National Grid NH residential heating customer actually decreased by approximately 15% on average, while annual gas consumption by a typical residential non-heating customer decreased by approximately 6% on average. As natural gas prices have increased, customers have adapted their energy consumption patterns in an effort to reduce their overall energy bills, a trend that has been actively supported and encouraged by the Company and the Commission. By doing the right thing and implementing programs to advance the policy objectives of New Hampshire policymakers and assisting customers in reducing their gas consumption, however, the Company adversely affects its ability to recover the allowed revenue requirement and potentially undermines its own financial health by reducing throughput on its system. Moreover, other factors unique to New Hampshire, including the geographic and demographic characteristics of the Company's service territory and regulatory prohibitions on the recovery of advertising and marketing costs further affect our ability to attract new customers to our system, compounding the situation for the Company.

Q. What is the Company's proposal to address the trend of essentially flat usage use per customer?

A. To address this problem, the Company is proposing a revenue decoupling mechanism that will better align the Company's financial interest with customers' interest in reducing their utility bills through energy efficiency and conservation. Under traditional ratemaking, the Company's revenues are tied to its level of sales, so that the Company's ability to achieve its revenue requirement is dependent on its ability to sustain sales at test year levels. Under such a structure, customers' efforts to lower their energy bills by reducing their energy usage have a direct and negative impact on the Company's revenues and, therefore, its ability to earn its authorized return. Because this ratemaking structure provides a disincentive to gas and electric companies to aggressively support energy efficiency and conservation measures, an increasing number of states have approved revenue decoupling mechanisms to break the link between customers' level of consumption and the utility's revenues. As noted in a recent AGA report, there are now thirty-four gas utilities across the U.S. that are providing service to 22 million residential customers (approximately one-third of the residential customers in the U.S.) in seventeen states under decoupled rates. In addition, revenue decoupling proposals are pending in another five states. As U.S. Energy Secretary Dr. Stephen Chu stated at a recent AGA conference that I attended, we need policies that will align business goals of the gas industry with our environmental goals. Without revenue decoupling, the ongoing trend of flat usage per customer that the Company has experienced in recent years will continue to negatively impact the Company's earnings. Revenue decoupling will better align the Company's financial motivations with the goal of achieving greater energy efficiency. Dr. Tierney describes the Company's revenue decoupling proposal in her testimony.

Q. You mentioned the Company's ongoing investment in its distribution system as one of the major reasons that the Company has been unable to earn its allowed return. Please describe the Company's recent investment in the system and its plans for future capital investment.

A. As set forth in the testimony of Susan Fleck, the Company's Vice President of Engineering Standards and Policy, the Company's rate base has invested an additional $36.9 million in the two-year period since the test year in its last base rate. Although the Company's distribution system is generally in good condition from a reliability and integrity standpoint, the age of the system still requires ongoing replacement of that infrastructure. As shown in Figure NS-1, National Grid's gas distribution system overall is aging at a rate of five months every year, which has also been the case for the National Grid NH system as of the same time period. In an effort to address this need, over the next five fiscal years (*i.e.* April 1, 2010 to March 31, 2015), the Company plans to invest $42 million in reliability and integrity projects alone. In addition, the Company plans to invest $21 million in mandatory work associated with public works projects, main encroachments, and other similar situations and $0.3 million in capital equipment purchases, bringing the total of non-growth-related investment to approximately $63 million. In other words, the Company plans to increase its capital investment by $63 million for projects that will not generate any additional revenue to support that investment.

Q. What is the relationship between that investment and the rate relief being requested in this case?

A. More than half of the Company's capital investment in recent years has been for non-revenue-producing projects. Because these projects do not result in the addition of new customers or increased throughput on the Company's system, they do not add incremental revenues and, therefore, directly reduce the Company's earned return on its overall investment until the Company obtains rate relief. A significant portion of these non-revenue-producing projects relates to work the Company performs in connection with public works projects. Federal economic stimulus spending has the potential to further widen the gap between earnings and investment by encouraging municipalities to expand public works projects, thereby requiring the Company to replace or relocate certain facilities more frequently than in recent years to accommodate these municipality-driven projects.

Q. In the KeySpan/National Grid merger proceeding, DG 06-107, the Commission approved a CIBS rate adjustment mechanism. Why hasn't that been sufficient to address the concern you are raising regarding the Company's earned return?

A. Although the CIBS rate adjustment mechanism has been a positive addition in terms of dealing with the need to support a portion of the Company's non-revenue-producing investments, a majority of the types of projects I just described are outside the scope of the CIBS mechanism. Of the Company's total capital investment relating to non-revenue-producing projects, more than half is not covered by the CIBS rate adjustment mechanism. In addition, the CIBS program as currently constituted excludes the first $500,000 of investment each year.

III. DISCUSSION OF MARKET AND INDUSTRY CHALLENGES

Q. Are there any significant changes in today's capital markets that you would like to discuss that have impacted the Company's cost of capital since the last rate case?

A. As supported by the testimony of Robert B. Hevert, President of Concentric Energy Advisors, Inc., in light of recent capital market conditions, the Company's cost of equity currently is in the range of 10.30% to 11.30%. Although economic conditions have moderated somewhat since the financial market crisis and subsequent economic downturn began in 2008, industry analysts have noted the challenges utilities face with respect to the combined effects of regulatory lag, uncertain capital cost recovery, and increased risk aversion among investors. Securities analysts pay close attention to the outcomes of the various rate cases that National Grid is pursuing across its U.S. service territories on both the gas and electric sides of the business. As noted by Morgan Stanley in a research report dated September 10, 2009, two-thirds of National Grid's U.S. businesses earn returns "below acceptable levels, and well below the returns allowed by state regulators". In Morgan Stanley's view, National Grid's ability to return to the level of profitability expected by the market will be "driven by successful regulatory rate cases." While the Company is a relatively small part of National Grid's U.S. business, Morgan Stanley observed that the "small gas rate cases are the first step" in building confidence in the U.S. business.

Q. Are there any other significant changes in today's energy industry that you would like to discuss that have impacted the Company's operations?

A. Yes. Times have changed such that it is no longer sufficient for gas companies to solely play their traditional role of delivering energy supplies. In our view, energy utilities should take a leadership role in actively promoting energy efficiency and conservation measures, developing innovative end-use technological solutions to manage energy usage, and demonstrating a commitment to reducing carbon emissions to safeguard our environment for future generations. Because natural gas is the least environmentally harmful fossil fuel and is inherently efficient, it is the preferred energy solution for the foreseeable future. As a global leader in the energy industry, National Grid seeks to play a key role in shaping and meeting energy policies and goals nationally and in the states where it does business. While the Company is committed to safeguarding the environment for future generations through its numerous climate change initiatives and supports and encourages customers in their energy conservation and efficiency efforts, these increasingly important environmental necessities and realities exert significant downward pressure on revenues flowing to the Company.

Q. You have stated that National Grid as a whole is very committed to safeguarding the environment for future generations through its numerous climate change initiatives. What are some of National Grid's specific climate change initiatives that benefit the Company and its customers?

A. National Grid has established one of the most aggressive greenhouse gas reduction goals in the industry, seeking to reduce its carbon emissions by 80% by 2050. This goal affects the Company, the affiliates that provide services to the Company, and all National Grid subsidiaries. As one of the first companies to implement carbon budgets, we have sharpened the focus of management and our entire workforce on reducing carbon emissions and electricity usage in our business. For instance, National Grid has added new vehicles to our vehicle fleet that have fewer emissions and are more fuel efficient. National Grid is committed to supporting promising technology with potentially large impacts and to helping commercialize those with clear commercial potential, such as carbon capture and storage/sequestration. National Grid established a Sustainable Gas Group to ensure that gas remains a sustainable source of fuel and to pursue several initiatives that are underway with respect to renewable natural gas (also called biomethane). The production of biogas from various feedstocks is one such renewable gas initiative that National Grid is evaluating which could have significant investment potential in New Hampshire and an impact to the local economy in terms of job creation.

Q. What are some of the specific efforts the Company is making to reduce carbon emissions or otherwise improve the environment?

A. The largest contributor to carbon emissions for the Company, and the U.S. gas distribution business in general, is gas leaking into the atmosphere. By investing in our system to reduce gas leaks and eliminate leak prone pipe, we not only improve the integrity of our system, as well as its safety and reliability for customers and communities, but simultaneously provide a significant environmental benefit through elimination of methane emissions. In addition, energy efficiency programs play a central role in climate change policy and are among the most cost-effective ways available to reduce greenhouse gas emissions. As a part of National Grid's recently announced recycling goals for its U.S. operations, the Company will also step up its efforts to recycle road spoils (pavement and soils generated when excavations are completed in roadways that cannot be returned to the excavation site), trash at both fixed sites and construction sites, and SIR wastes (wastes generated during our clean up efforts at former manufactured gas plant sites).

Q. In addition to being part of an organization that is a leader in addressing environmental concerns, how does the Company benefit from being part of the larger National Grid organization?

A. The Company and the customers and communities it serves benefit from the many initiatives in the areas of safety, quality and performance management, technology and innovation, customer service and market development that National Grid develops and implements throughout the organization. I will summarize some of these below.

A. Safety

At National Grid, safety is our top priority. We believe that safety is an obligation we have to customers, employees, contractors, and the public. Our objective is to ensure that a safety-first culture becomes an inherent part of our organization at every level. Our robust safety initiatives focus on several key areas, including prevention of soft tissue injury and slips, trips, and falls as well as process and driver safety. Another program we are particularly proud of is our "Safe and Unsafe Acts" program where we engage the management team and workforce in real-time safety discussions and job site coaching to ensure that our employees and contractors always keep safety at the forefront. We also perform risk assessments of routine tasks, conduct pre-job briefings with work teams prior to beginning tasks to ensure personal safety, and train our employees and contractors to recognize potentially dangerous situations that put them at risk. By providing employees and contractors with state-of-the-art tools, equipment, clothing, and ongoing training and feedback to continuously improve their performance, we ensure that our operating assets are installed and maintained safely and efficiently in an effort to achieve National Grid's aggressive overall safety goal of zero injuries.

B. Customer Satisfaction

Customer satisfaction is also a top priority for National Grid. As an example, we established a group whose sole purpose is to serve customers who need assistance in either establishing gas service or moving existing services. Having a single point of contact for all customer-requested work benefits customers and improves customer satisfaction. Ms. McCarthy also discusses the Company's plan to add "Consumer Advocates" to assist lower income customers in accessing applicable benefit programs. In addition, the Company has continued to improve its Call Center performance and to meet its leak response time goals as Ms. Fleck notes in her testimony.

C. Quality and Performance Management

Another primary area of focus at National Grid is quality and performance management. We have a group of experts in the energy field who measure quality in a number of ways, including inspections and audits, operations and construction analysis and support, and advanced quantitative analysis to optimally allocate resources while minimizing labor costs. The ReDig program described by Ms. Fleck is just one such program we have instituted in this area.

D. Technology and Innovation

In addition to the key holing technology that Ms. Fleck discusses in her testimony, National Grid is developing other low dig technologies that benefit customers and municipalities. Among them is the Cast Iron Internal Sealing Robot ("CISBOT") that seals large-diameter cast iron joints under live gas conditions, resulting in less interruption of service and less inconvenience to customers. National Grid utilizes Horizontal Directional Drilling ("HDD") to install new main in its main replacement process, thus reducing restoration costs associated with the open-trenching method of main replacement. These low dig technologies benefit customers, communities, and the general public by reducing road disruption and restoration, thereby minimizing inconvenience, and benefit the environment by re-using excavated material and reducing noise levels when roadways are excavated and carbon emissions when gas leaks are repaired.

E. Gas Purchasing and Dispatch

The coordination of gas supply purchasing with National Grid's three local distribution companies ("LDCs") in Massachusetts also provides significant benefits to the Company and its customers. The Company's customers benefit from economies of scale and scope that were not available when the Company performed these functions on its own. For example, shortly after the KeySpan merger, the Company coordinated its contract-renewal negotiations with its primary pipeline supplier with those of the Massachusetts LDCs, greatly increasing the Company's bargaining power. With a single operational balancing agreement with the pipeline supplier for all New Hampshire and Massachusetts citygates, the Company and the Massachusetts LDCs were able to balance deliveries across all of these citygates. A second example of the benefits of coordination with the Massachusetts LDCs is that of displacement, which combines the benefits of the single operational balancing agreement I just mentioned and the use of on-system supply and distribution assets between the Company and the Massachusetts LDCs. On any given day, the Massachusetts LDCs may make LNG available to the Company by vaporizing LNG into their systems and "delivering" it to the Company through displacement on its distribution system and the supplier's pipeline. Because National Grid has a single operational balancing agreement for New Hampshire and Massachusetts, the Company incurs only the commodity cost of the LNG and avoids the cost of LNG trucking or pipeline transportation costs to which it otherwise would have been subject.

IV. SUMMARY OF THE COMPANY'S RATEMAKING PROPOSALS AND THEIR BENEFITS

Q. Please provide an overview of the Company' proposals in this proceeding to reduce the frequency of rate cases and achieve a level of continuity and stability for the Company and its customers.

A. The Company's filing is based on traditional ratemaking principles with some modifications that are largely within the confines of what the Commission has authorized previously. These modifications are designed to address the operational and economic challenges facing the Company and the regulatory lag inherent in New Hampshire ratemaking that make it effectively impossible for the Company under current circumstances to obtain an adequate level of cost recovery and maintain rate stability over the long term. To summarize, the key elements of the Company's proposal are:

- Expansion of the annual CIBS rate adjustment mechanism to include public works projects and eliminate the current $500,000 threshold.
- Rate adjustment mechanism to reflect changes for certain known and measurable costs (pensions, OPEBs, and commodity-related bad debt) relative to the test year amounts included in base rates with net credits or surcharges flowing through the LDAC.
- Inflation adjustment net of assumed productivity factor for certain operating expenses.
- Revenue decoupling mechanism.

In making its request for new rates, the Company is aware that this is a difficult time for customers to deal with another rate adjustment. However, the Company's revenues are not sufficient to provide timely recovery of the costs incurred and capital investments made by the Company to provide high quality service to its customers. Timely cost recovery is vital for the Company to ensure proper cash flow to support its investment in the system and ensure that its operating and maintenance costs are covered. The Company believes that, if approved by the Commission, its proposal would restore the Company's ability to fund utility operations in New Hampshire on a sustainable going forward basis.

The Company recognizes that frequent rate filings place an extraordinary burden on the Commission and create additional costs that are largely borne by the Company's customers. They also place a considerable drain on the Company's resources. The Company believes that, if adopted, the proposals it has put forward in this case will greatly diminish the need for another rate case in the immediate future. If the Company is ultimately able to reach agreement with the Commission staff on a resolution that is consistent with the Company's proposal in this case, it would also be willing to consider entering into a stay-out commitment for a two-year period after the date of a Commission order if the return on equity approved for the Company reflected an appropriate adjustment for the additional risk such a commitment would impose. In order to facilitate such an agreement, Mr. Hevert's testimony attempts to estimate the impact that such a commitment should have on the Company's allowed return, and the return on equity utilized by the Company in its filing in this case (11.2%) assumes that such an agreement would be reached.

Q. Why should the Commission approve the Company's proposal in this proceeding?

A. The Company believes that it is in the public interest for the Commission to approve the Company's proposal, which is designed to benefit customers by enhancing the Company's ability to provide reliable, safe, and efficient service while supporting the Commission's long-standing overall ratemaking goals of assuring just and reasonable rates and providing the Company with a real opportunity to earn a fair return on its investment. In addition, the proposal is designed to reduce the frequency of rate cases, resulting in cost-savings to customers, more productive deployment of resources by the Company and the Commission, and supporting the Company's and the Commission's shared goals of supporting energy efficiency, enhancing the reliability and safety of the Company's system, providing rate stability, and improving customer service.

These are challenging times for the Company, its customers and the communities it serves. We need support from, and to work with, the Commission to develop a strong, sustainable regulatory framework with flexibility to address these important business challenges while ensuring financial integrity of the utility to accomplish our shared goals of safe, reliable, and efficient service to customers. Without a fair opportunity to recover all of our prudently incurred costs required to provide this service to customers and earn a reasonable return on our investment in New Hampshire, the Company is engaging in a form of deficit spending and must look to others to make up that deficit. It is simply unfair to expect National Grid's customers in other jurisdictions and National Grid's lenders and owners to make up that deficit. If the Company were a small stand-alone company operating in New Hampshire under the existing regulatory paradigm, it would be in a downward financial death spiral. The longer this is allowed to continue, the more difficult it will be to dig out from such a situation.

V. CONCLUSION

Q. Do you have any summary comments on the Company's proposals in this proceeding?

A. As I stated above, the Company's proposals in this proceeding are designed to mitigate or eliminate the impact of the factors that persist in undermining the Company's ability to recover its allowed revenue requirement following the completion of this case and that will not be addressed through the establishment of rates based exclusively on the Company's historical test-year data with the limited expense updates that the Commission has traditionally recognized. The proposed ratemaking framework is absolutely necessary to provide the Company with sufficient revenues to conduct its business for the benefit of customers, maintain safe and reliable service, and meet public policy obligations while allowing the Company to earn a reasonable rate of return and ensuring that its natural gas business remains vibrant and secure for the future.

Q. Please provide an overview of the testimony being provided by the various witnesses who are appearing on behalf of the Company in this case.

A. The Company's filing is set forth in the testimony of ten witnesses, in addition to my own. These testimonies are as follows:

Susan F. Tierney, PhD.—Dr. Tierney is a Managing Principal for Analysis Group, Inc. and a former Commissioner of the Massachusetts Department of Public Utilities. Dr. Tierney's testimony discusses the challenges the Company is facing with regard to its ability to earn its allowed rate of return and the proposals the Company is making to earn the return allowed by the Commission in this proceeding. Dr. Tierney also presents the Company's proposal for revenue decoupling, which is designed to further support the state's and this Commission's energy efficiency goals.

Frank Lombardo and Michael J. Adams—Mr. Lombardo is a Director of Revenue Requirements for the US Gas Distribution business for National Grid. Mr. Adams is a Vice President with Concentric Energy Advisors, Inc. Mr. Lombardo and Mr. Adams are providing joint testimony that sets forth the calculation of the overall revenue requirement and resulting revenue deficiency for the Company and provides the calculation of the Company's overall rate of return. Mr. Lombardo and Mr. Adams have also submitted separate testimony in support of the Company's proposal for temporary rates.

Susan Fleck—Ms. Fleck is the Vice President of Engineering Standards and Policy for National Grid. Her testimony describes the gas operations of the Company and its system investment plans, including the capital improvements to the system since the Company's last base rate case and the impact of the Company's non-growth capital investments on the Company's ability to earn its allowed rate of return.

Robert B. Hevert—Mr. Hevert is President of Concentric Energy Advisors, Inc. Mr. Hevert's testimony presents evidence and provides a recommendation regarding the Company's cost of equity as well as discussing the basis for the cost of debt applied by the Company to derive its weighted average cost of capital.

Tracey McCarthy—Ms. McCarthy is Vice President of Customer Financial Services for National Grid. Her testimony discusses the Company's collection practices, the current level of uncollectible accounts expense and the factors affecting it, the current and proposed methods of recovering uncollectible accounts expense, and planned initiatives to mitigate continued upward pressure on the Company's level of uncollectible accounts. Ms. McCarthy's testimony also briefly addresses past criticisms of the Company's collection practices that were raised by the Commission staff and its consultant, Mr. Bruce Gay of

Monticello Consulting Group, in a report filed on behalf of Staff in the Company's last rate case.

Mark Hirschey—Mr. Hirschey is an Associate Partner in the utilities practice at Oliver Wyman, a subsidiary of Marsh McLennan Companies. Mr. Hirschey's testimony provides an independent assessment of the Company's collections practices that Oliver Wyman performed and addresses the conclusions set forth in Mr. Gay's report.

Ann Leary—Ms. Leary is the Company's Manager of Pricing—New England. Her testimony discusses the Company's test year revenue and gas cost adjustments, bill impacts of the rate changes being proposed by the Company, and other proposed changes to the Company's tariff.

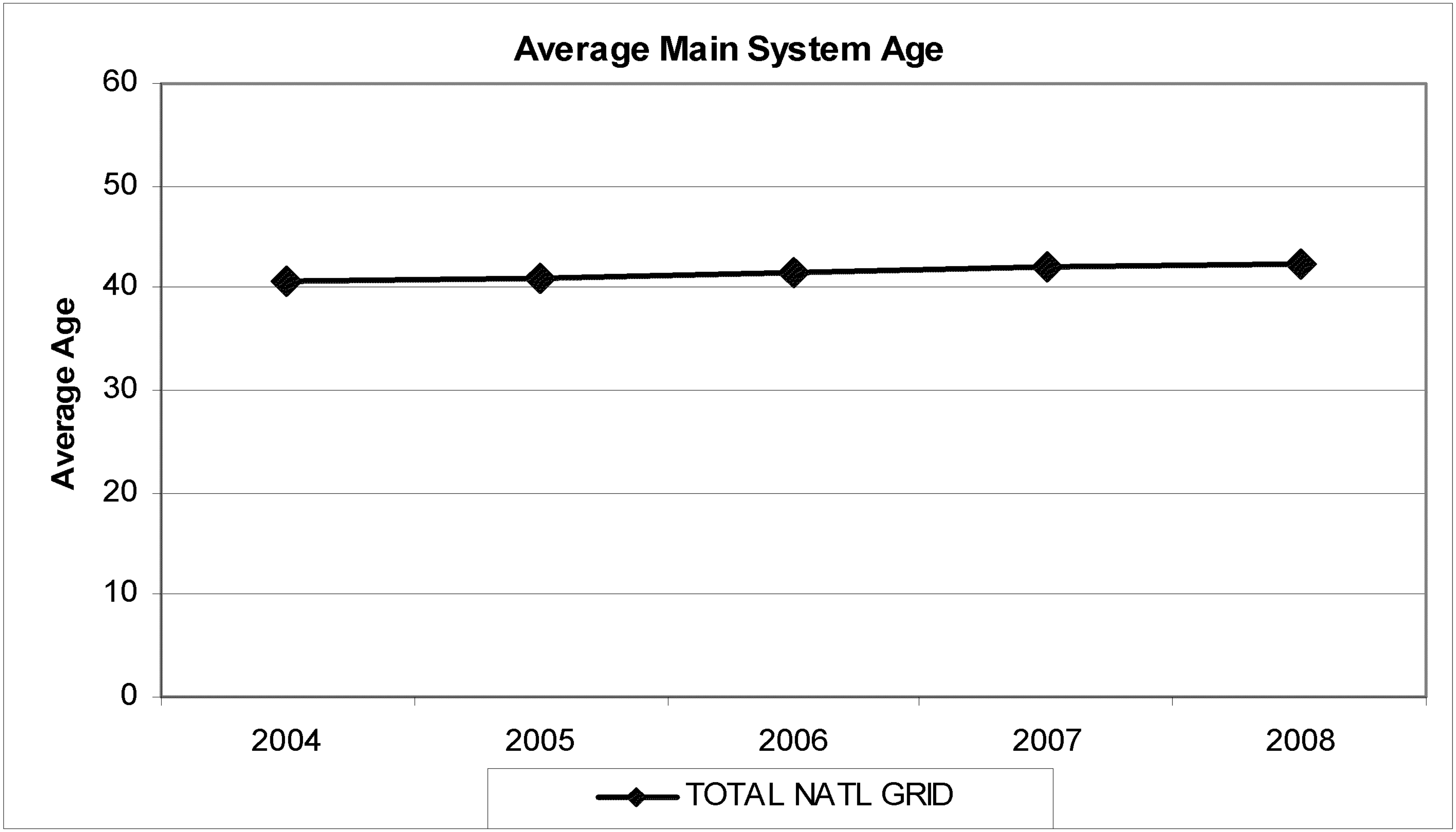
Paul Normand—Mr. Normand is a management consultant with the firm of Management Applications Consulting, Inc. Mr. Normand's testimony presents the Company's proposed rate design, allocated and marginal cost of service and lead lag studies.

Kevin M. Spottiswood—Mr. Spottiswood is employed by the Company as a Foreman and currently serves as President of Local 12012-03 of United Steelworkers of America. In his testimony, Mr. Spottiswood provides his observations as an employee of the Company regarding the changes he has seen in how the Company interacts with its employees and provides service to its customers since the merger between KeySpan and National Grid in 2007.

Q. Does this conclude your testimony?

A. Yes, it does.

National Grid Gas Distribution System is Aging at a rate of 5 months every year



Source: National Grid, System Integrity (2008 figures); Data only available from 2004

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