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May 15, 2007

Ms. Debra Howland
Executive Director and Secretary
New Hampshire Public Utilities Commission
21 South Fruit Street, Suite 10
Concord, New Hampshire 03301

RE: DG 06-107 National Grid/KeySpan Merger

Dear Ms. Howland:

Enclosed is the testimony of Stephen P. Frink, Assistant Director, Gas & Water Division and Steven E. Mullen, Utility Analyst III for Staff, in support of the Settlement that is being filed today by National Grid under separate cover.

If you have any questions, please feel free to contact me.

Sincerely,

Edward N. Damon

Edward N. Damon
Staff Attorney

Enclosures

CC: Service List

STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

DG 06-107

In the Matter of:
National Grid/KeySpan Energy Corporation
Joint Petition for Approval of Merger

Direct Testimony

of

Stephen P. Frink
Assistant Director, Gas & Water Division

May 15, 2007

New Hampshire Public Utilities Commission

National Grid plc &
KeySpan Corporation

Joint Petition for Approval of Merger

DG 06-107

Testimony
Stephen P. Frink

Q. Please state your name, occupation and business address.

A. My name is Stephen P. Frink and I am employed by the New Hampshire Public Utilities Commission (Commission) as Assistant Director of the Gas & Water Division. My business address is 21 S. Fruit Street, Suite 10, Concord, New Hampshire 03301.

Q. Please summarize your educational and professional experience.

A. Please see ***Attachment SPF-1***.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to summarize and support the Settlement Agreement (Settlement) between Staff, Office of the Consumer Advocate (OCA) and National Grid on the merger of National Grid and KeySpan as it relates to EnergyNorth Natural Gas, Inc. d/b/a KeySpan Energy Delivery New England (ENGI or Company).

Q. Please summarize the merger proposal contained in the Joint Petition.

A. The petition estimated company wide savings of approximately $200 million and a total cost to achieve (CTA) of $400 million, with an allocated net savings of $12.8 million to ENGI over ten years. The petition proposed that: prior to ENGI filing its first rate case, all synergy savings would accrue to ENGI; ENGI delivery rates be frozen for one year beyond the closing; ENGI be allowed to add 50% of the estimated annual savings to its revenue requirement in future rate cases; estimated CTA be amortized over 20 years; and, ENGI would not seek recovery of the acquisition premium associated with the merger.

The petition stated that ENGI expected the merger to create gas supply benefits to be reflected in ENGI's cost of gas rates and to improve ENGI's response to customer telephone calls by updating the service quality standards at the time of ENGI's next delivery rate case. In addition, the merger would allow ENGI to avoid capital investments and billing and information systems costs that would otherwise be incurred by a stand-alone company.

Q. What were some of Staff's concerns related to the proposal?

A. Concerns with the proposed rate treatment included: if there are substantial savings, ENGI may over earn and customers would not share in those savings until delivery rates were adjusted through a future rate case proceeding; if net savings were never realized, not only would ratepayers not get the benefit of reduced costs, they would be paying additional costs as ENGI would be recovering 50% of projected net savings; and, projected CTA would be amortized over 20 years though actual CTA could be considerably less, in which case ratepayers would be paying for costs not actually incurred.

The Petition did not address public safety issues that have arisen since the KeySpan/ENGI merger. The number of leaks on ENGI's system has increased, as has the time it takes ENGI to respond to odor complaints (emergency response time). The ENGI emergency response time has increased to the extent that the Gas Safety Division filed a memorandum with the Commission on December 14, 2006, requesting that the Commission require ENGI to begin reporting emergency response times on a monthly basis and suggesting the Commission consider initiating a rule change to establish response time performance standards.

Q. Please summarize the terms of the Settlement.

A. Key elements of the Settlement as it relates to ENGI's first delivery rate filing include:

- Delivery rate filing no later than six months from the merger close;
- Delivery rates frozen until 1 year beyond the merger close;
- First rate filing to credit 50% of estimated annual net savings to ratepayers;
- CTA amortized over 10 years;
- Imputed capital structure of 50% debt and 50% equity.

Key elements of the Settlement as it relates to ENGI's second delivery rate filing include:

- 50% of proven annual net saving added to revenue requirement;
- Actual net annual savings determined no later than 5 years from the merger close;
- No net savings added to revenue requirement in subsequent rate filings;
- If second rate case filed 10 years beyond the close of the merger, no net savings added to the revenue requirement;
- Actual CTA amortized over 10 years.

Key elements related to customer service and safety standards include:

- Improve call answering to 80% within 30 seconds;
- Minimum annual investment in replacement of cast iron and bare steel mains;
- Use of in-house personnel for marking underground facilities for at least 2 years;
- Establishment of emergency response time standards.

Q. How does the Settlement address Staff's concerns related to rate issues?

A. ENGI ratepayers will benefit from projected net synergy savings. ENGI must file a rate case within 6 months of the merger and include 50% of the estimated annual net savings, meaning customers will realize the expected merger savings when delivery rates are adjusted after year one. This is significant because the CTA are greatest in the first year and annual savings at their lowest, as cost saving measures are implemented over time following the close of the merger. Ratepayers will be credited substantial net merger savings before those savings are actually, if ever, realized.

When calculating the revenue requirement in the first rate case, ENGI will use an imputed capital structure of 50% debt and 50% equity rather than the current capital structure of 40% debt and 60% equity. The imputed capital structure is more balanced and is expected to reduce the overall allowed rate of return, thereby avoiding higher rates due to the Company being disproportionately financed by equity.

If ENGI files a second rate case within five years of the close of the merger, ENGI will be allowed to add 50% of proven annual net merger savings to the revenue requirement. The savings will be determined by comparing ENGI administrative and general expenses (primarily corporate service charges) with those calendar year 2005 benchmarked expenses adjusted for inflation. The benchmarked expenses do not include New Hampshire field personnel, thereby eliminating any incentive to reduce field personnel in order to earn 50% of those savings in a future rate case. ENGI will track the CTA and only recover actual CTA costs. The CTA will exclude costs associated with supplemental executive retirement plans such as golden parachutes.

If ENGI does not file a rate case within five years of the merger close, ENGI will make a savings proof filing at the end of year five. In ENGI's next delivery rate filing, it would be allowed to recover 50% of the proven savings determined in the savings proof filing, unless the next filing is 10 years beyond the merger close, in which case there would be no merger savings added to the revenue requirement.

In summary, ratepayers will benefit from anticipated net merger savings and ENGI may only share in proven net merger savings, as ratepayers receive 50% of anticipated net merger savings soon after the merger is consummated and ENGI shares in 50% of *proven* net merger savings through a one time rate adjustment.

Q. How does the Settlement address Staff's concerns related to customer service issues?

A. As a condition of the EnergyNorth/KeySpan merger, ENGI is required to file monthly reports on its call center performance. ENGI reported a service level of 80% of calls answered in 40 seconds for 2002 through 2004, 80% of calls answered in 120 seconds for 2005 and 80% of calls answered in 40 seconds in 2006.

The Settlement provides for ENGI to meet or exceed a call center performance standard of 80% of calls answered within 30 seconds by the end of the first full calendar year following the merger close, a clear improvement over the level of customer service provided since the KeySpan/ENGI merger. As part of the merger integration plan, ENGI's customer information system will be consolidated with the National Grid system sometime after the merger. At that point, Staff will work with ENGI to develop a more comprehensive set of customer service standards, including any appropriate changes to the service level. Until a new set of customer service standards has been developed, ENGI's call center performance will meet or exceed 80% of calls answered in 30 seconds.

Q. How does the Settlement address Staff's concerns related to safety issues?

A. There are a number of measures related to safety, three of which I will touch upon. In particular, the Cast Iron/Bare Steel (CIBS) Replacement Program and establishment of emergency response time standards address Staff's concerns regarding the increase in gas leaks and emergency response time, and will be implemented upon approval of the Settlement, regardless of whether the merger is consummated. The third measure relates to ENGI continuing to use in-house personnel to mark gas lines.

The majority of system leaks occurs on cast iron and bare steel pipes. ENGI stopped installing cast iron mains and services in the 1950's and have also discontinued installing bare steel. The CIBS Replacement program is designed to accelerate the replacement of the cast iron and bare steel mains and services, the pipes most likely to develop leaks.

The Settlement also establishes emergency response times consistent with those achieved by ENGI prior to the KeySpan/ENGI merger, other New Hampshire gas utilities and required in other state jurisdictions.

Q. Please describe the CIBS Replacement Program.

A. Pipe replacement is driven by either external conditions (beyond the control of the Company, such as public works projects) or at the discretion of the Company (likely due to a high incidence of leaks or leak repairs on a segment of pipe). While ENGI has no control over the amount of pipe to be replaced due to external conditions, the CIBS Replacement Program requires ENGI to spend a minimum of $500,000 per year on discretionary CIBS pipe replacement. Discretionary expenditures above the base amount are eligible for recovery through an annual rate adjustment, subject to Commission review and approval. The program ensures that ENGI will invest a minimum of $500,000 annually in replacing mains and services most at risk of leaking and encourages additional investment if needed by providing ENGI the opportunity to recover prudent investments on a timely basis.

Q. When will ENGI be in compliance with the new emergency response time standards?

A. No later than January 1, 2008.

Q. Will ENGI be allowed recovery of the costs necessary to comply with the new emergency response standards?

A. Prudently incurred costs to meet the standard will be included in ENGI's first delivery rate case, to be recovered through rates beginning one year after the close of the merger. To achieve compliance at the earliest possible date and ensure compliance no later than January 1, 2008, ENGI intends to make the necessary investment as soon as practicable. The anticipated investment is substantial, expected to be well in excess of one million dollars. The Settlement establishes incentives ranging from $400,000 to $600,000 for meeting or exceeding the compliance date, thereby rewarding ENGI for achieving compliance as quickly as possible and enabling ENGI to recoup some of the compliance costs that would otherwise not be recovered through future rates. Failure to meet the compliance date will prevent ENGI from recovering any of its initial compliance costs.

Q. How does ENGI mark its gas lines for excavators and how has its performance been?

A. ENGI uses in-house personnel for marking its mains and services, as opposed to using outside contractors, and has performed well in this area.

Q. Is there an advantage to using in-house personnel to mark lines?

A. Yes. In-house personnel have a familiarity with the system that can make it easier to locate lines, identify and correct mapping errors and respond to related inquiries.

Q. How will ENGI mark its gas lines after the merger?

A. Although there is no regulatory requirement that ENGI use in-house personnel for marking lines, ENGI will continue to do so for a minimum of two years. Furthermore, ENGI will notify Staff at least six months in advance of any decision to use outside contractors and hold a technical session to explain the change and address any safety concerns Staff may have.

Absent the Settlement, ENGI would be within its rights to use outside contractors for line marking at any time without notice to Staff or the Commission.

Q. Are there increased costs related to the customer service and safety improvements?

A. While some improvements may be achieved through adopting 'best practices' and others achieved through efficiencies realized in connection with the merger, one would expect there to be some incremental costs related to raising customer service and safety standards above those being achieved at current costs. Additional costs, if any, have not been identified.

Q. Will ENGI be compensated for additional costs related to improved customer service and safety?

A. Other than the opportunity to recover investments above the base level established in the CIBS Replacement Program and incentives related to Emergency Response Standards, ENGI will not recover any additional costs absent a rate case. That said, ENGI will be filing a rate case within six months of the close of the merger and recovery of prudent costs will be begin one year following the close of the merger.

Q. How will Staff verify that the provisions in the Settlement will be adhered to?

A. In addition to reporting requirements established through Commission order and rules, the Settlement contains additional reporting requirements that will enable Staff to monitor progress towards meeting the provisions, and compliance with and maintenance of such standards thereafter.

Q. How does the Settlement compare to merger terms in New York?

A. The Settlement contains a provision that ensures ENGI ratepayers will share in the net synergy savings at a level no less than that granted ratepayers in New York, if, and when, those terms are established. As of this date, there is no settlement agreement in New York and the New

York Public Service Commission has not ruled on the National Grid/KeySpan merger.

Q. Any other Comments regarding the Settlement?

A. The Company's recent quarterly rate-of-return reports indicate that ENGI is earning well below its allowed rate of return and, therefore, a rate increase may be appropriate. The one year rate freeze ensures ratepayers will not see an increase in delivery rates until one year after the close of the merger and the new rates will contain a credit for anticipated net synergy savings. ENGI only shares in proven net merger saving, if any, through a one time adjustment to the revenue requirement in its second rate case, after which net merger savings flow entirely to ratepayers. The Settlement also precludes recovery of the acquisition premium, avoiding potential future litigation over that issue.

Under the terms of the Settlement ratepayers will see improved customer service, as customer calls will be answered more quickly, and public safety should improve as ENGI accelerates the replacement of mains and services prone to leaks and emergency response times decease.

Q. Please summarize your recommendations.

A. Staff recommends that the Commission approve the Settlement. Whether examined in terms of "no net harm" or "net benefits," the terms and conditions provided in the Settlement allow the transaction to meet either standard.

Q. Does that conclude your testimony?

A. Yes.

Stephen P. Frink

Educational & Professional Experience

Mr. Frink graduated from the University of New Hampshire with a Bachelor of Arts degree in Sociology in 1977 and a Masters in Business Administration in 1980. He attended and completed Depreciation Programs sponsored by Depreciation Programs, Inc. at Grand Rapids, Michigan in 1992, 1993, 1994 and is a member in good standing of the Society of Depreciation Professionals since 1994.

In 1981, Mr. Frink worked as a High School Math Teacher in Manchester, New Hampshire.

In 1982, Mr. Frink relocated to Texas and worked as an Auditor for Dallas County. He audited various county departments and performed monthly reconciliations of various fund accounts.

In 1985, Mr. Frink went to work for Schenley Industries, Inc., a wholesale liquor distributor located in Dallas, Texas, where he audited national and international manufacturing plants.

In 1986, Mr. Frink left Schenley to work for the City of Dallas as a Budget/Financial Analyst, where he prepared and monitored budgets, prepared pro forma statements, amortization schedules and performed cash flow analysis. He was promoted to Senior Analyst in 1987.

In 1988, Mr. Frink left the City of Dallas to work for the City of Austin as a Financial Analyst. There he prepared budgets and fiscal impact statements, developed a capital projects tracking and monitoring system, and provided training and technical assistance in the implementation of a new accounting system.

In 1990, Mr. Frink joined the Finance staff of the New Hampshire Public Utilities Commission. Working as a member of the PUC Audit Team, he conducted or participated in audits of the books and records of public utilities. He performed desk audits and determined rates of returns. He prepared schedules and exhibits supporting testimony in dockets involving rate increases and participated in settlement conferences. In 1995, Mr. Frink became a full time Analyst for the Finance Department and in 1996 was promoted to a Senior Analyst position, primarily responsible for analyzing and advising the Commission on issues of depreciation, cost of gas adjustment filings, special contracts, and finance and rate increase petitions. In 1998, Mr. Frink was promoted to Assistant Finance Director. As Assistant Finance Director, he assisted in the direction of all aspects of a department responsible for the audit, analysis and review of public utility financial operations, including financing, rate cases and various utility studies filings related to public utility regulation. In 2001, New Hampshire Public Utilities Commission operations were restructured and Mr. Frink became Assistant Director of the Gas & Water Division and now administers all aspects of regulation of gas utilities.

STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

DG 06-107

In the Matter of:
Joint Petition of National Grid plc and KeySpan Corporation
for Approval of Merger and Other Regulatory Approvals

Direct Testimony

of

Steven E. Mullen
Utility Analyst III

May 15, 2007

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I. INTRODUCTION AND SUMMARY

Q. Please state your name, position and business address.

A. My name is Steven E. Mullen. I am employed by the New Hampshire Public Utilities Commission in the position of Utility Analyst III. My business address is 21 South Fruit Street, Suite 10, Concord, New Hampshire.

Q. Please summarize your educational background and work experience.

A. In 1989, I graduated *magna cum laude* from Plymouth State College with a Bachelor of Science degree in Accounting. I attended the NARUC Annual Regulatory Studies Program at Michigan State University in 1997. In 1999, I attended the Eastern Utility Rate School sponsored by Florida State University. I am a Certified Public Accountant and have obtained numerous continuing education credits in accounting, auditing and utility related courses.

From 1989 through 1996, I was employed as an accountant with Chester C. Raymond, Public Accountant in Manchester, NH. My duties involved preparation of financial statements and tax returns as well as participation in year-end engagements. In 1996, I joined the Commission as a PUC Examiner in the Finance Department. In that capacity I participated in field audits of regulated utilities' books and records in the electric, telecommunications, water, sewer and gas industries. I also performed rate of return analysis, participated in financing dockets and presented oral testimony before the Commission. In 1998, I was promoted to my current position of Utility Analyst III and continued to work in all of the regulated industry fields, although the largest part of my time was concentrated on electric and water issues. As part of an internal reorganization of the Commission's Staff in 2001, I became a member of the Electric Division. I am responsible for the evaluation of rate, financing and accounting filings, including recommending changes in revenue levels. I represent Staff in meetings with company officials, outside attorneys, accountants and consultants relative to the Commission's policies, procedures, Uniform System of Accounts, rate case, financing and other general industry matters.

Q. **Have you previously testified before this Commission?**

A. Yes. I have testified before the Commission on numerous occasions.

Q. **What is the purpose of your testimony?**

A. The purpose of my testimony is to provide Staff's recommendations regarding the Joint Petition of National Grid and KeySpan for approval of their merger petition. Specifically, I will be providing recommendations regarding a Settlement Agreement that is being filed concurrently with this testimony and contains three main documents: i) a Settlement Agreement on the Merger Transaction Between National Grid and KeySpan (Merger Settlement); ii) a Rate Plan Settlement for Granite State Electric Company (GSEC Rate Plan); and iii) an EnergyNorth Merger Rate Agreement.

Q. **Do your recommendations cover all three documents?**

A. No. While all of the documents are an integrated package, I will not be providing recommendations regarding the EnergyNorth Merger Rate Agreement. Staff's recommendations concerning that agreement are included in the testimony of Stephen P. Frink, Assistant Director of the Gas and Water Division, who is also filing testimony in this proceeding.

Q. Is any additional testimony being filed in support of the three agreements?

A. Yes. Ronald T. Gerwatowski, Vice President of Distribution Regulatory Services for Granite State Electric Company, and Michael D. Laflamme, Manager of Regulatory Support for National Grid USA Service Company, Inc., will also be filing testimony.

Q. Please summarize your recommendations.

A. Staff recommends that the Commission approve the Merger Settlement. As part of that approval, Staff also recommends that the Commission adopt the terms and conditions of the GSEC Rate Plan. Whether examined in terms of "no net harm" or "net benefits," the terms and conditions provided in the settlement documents allow the transaction to meet either standard. Approval by the Commission would result in GSEC customers experiencing significant and immediate rate reductions, along with commitments by GSEC to improve system reliability and maintain its high levels of customer service.

Q. Please describe your involvement in this proceeding.

A. I participated in settlement negotiations and in the preparation of the settlement documents I've just described.

Q. Please describe how you've organized your testimony.

A. I begin with a general discussion of the Merger Settlement. Then, following a brief discussion of GSEC's earnings and reliability performance, I describe in detail many of the terms and conditions of the GSEC Rate Plan, following the same outline as in the filed documents.

II. MERGER SETTLEMENT

Q. Please summarize the Merger Settlement.

A. The Merger Settlement sets forth the agreement of the Settling Parties and Staff that the acquisition of KeySpan by National Grid (the Joint Petitioners) meets all applicable legal standards. The Settling Parties and Staff have also agreed to, and seek approval for, conditions related to inclusion of EnergyNorth with National Grid's other regulated subsidiaries in a regulated company money pool; consolidation of the service companies of National Grid and KeySpan; changing EnergyNorth's fiscal year to the year ended March 31st; and EnergyNorth's ability to pay dividends from its retained earnings. In addition, the Merger Settlement contains various commitments by the Joint Petitioners regarding reporting requirements and access to data. Finally, the Merger Settlement describes and includes the GSEC Rate Plan and EnergyNorth Rate Agreement, each of which provide for a settlement of rate and operational issues for the respective companies.

III. GSEC'S EARNINGS AND RELIABILITY PERFORMANCE

Q. Did the Companies' original merger filing include discussion of the level of GSEC's earnings and its reliability performance?

A. No.

Q. How did those issues come to be included in the merger proceeding?

A. Prior to and concurrent with the progression of the merger proceeding, the Electric Division had also been reviewing GSEC's annual earnings levels as well as the trends in GSEC's reliability indices, specifically the System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI). Regarding earnings, GSEC had been earning in excess of its allowed rate of return for the last three years, with the overearnings for calendar year 2006 amounting to over $2 million. As for the reliability statistics, the trends for the SAIDI and SAIFI indices showed a recent increase in both duration and frequency of interruptions. While the Electric Division had been considering asking the Commission to open dockets to investigate GSEC's rate of return and reliability performance, we determined that, with the merger proceeding ongoing, it would be opportune and administratively efficient to pursue the earnings and reliability issues in the context of the merger proceeding. Combining the issues also saves a great deal of time, money and effort for all parties involved.

Whether the merger is in the public interest and will have no adverse effect on the rates and operations of the New Hampshire utilities, i.e., GSEC and Energy North, are central questions in this docket. Typically, the focus is on the rates and operations of the utility being acquired. Where, as in this docket, the acquiring organization already owns a New Hampshire utility, it is relevant also to address the rates and operations of that utility in connection with the merger.

IV. GSEC RATE PLAN

i. DISTRIBUTION RATE REDUCTION

Q. You mentioned earlier that GSEC had been overearning. How has that been dealt with in the GSEC Rate Plan?

A. As described in Section 1 of the GSEC Rate Plan, GSEC will reduce its distribution rates by a total of $2.2 million annually. The rate decrease will happen in two phases, with $1.1 million of the decrease implemented on the Effective Date of the GSEC Rate Plan and the remaining $1.1 million of the reduction implemented for usage on and after January 1, 2008.

Q. What is the Effective Date of the GSEC Rate Plan?

A. The GSEC Rate Plan will take effect on the later of July 1, 2007 or thirty days following the Commission's approval of the merger.

Q. Are the rate reductions contingent upon the closing of the merger transaction?

A. No. While the rate reductions are contingent upon the Commission's approval of the merger, they will still be implemented regardless of whether the merger transaction closes or not.

Q. How will the rate reductions be allocated among GSEC's various customer classes?

A. For both phases of the rate reduction, GSEC's distribution rates will be adjusted on an equal percentage basis among all rate classes and rate design elements.

Q. If the Commission had opened a rate case to review GSEC's books, records and distribution earnings, among other things, how might the resulting change to GSEC's distribution rates coming out of such a proceeding differed from the rate reductions included in the GSEC Rate Plan?

A. It is impossible to predict with certainty the potential outcome of a rate case in the abstract. A rate case involves a highly detailed, comprehensive examination of a utility's books, records and operations. A utility's rate case filing typically contains a number of proforma adjustments for known and measurable changes to test year revenue and expenses levels, all of which need to be examined. Many times the utility will prepare a depreciation study, cost of service study, or perhaps other types of studies and will file testimony on controversial issues such as determining an appropriate return on equity. Rate cases can typically last for about a year from start to finish and can result in a significant amount of time, money and effort being spent by all involved in the course of preparing the filing, conducting and answering discovery, litigation and other procedural matters involved in a rate proceeding.

While we cannot predict what the outcome of a full investigation would have been, Staff entered into the settlement agreement because, on balance, it produces an immediate and significant rate reduction while balancing the financial interests of GSEC, provides for increased reliability and carefully delineates the circumstances under which GSEC may change its rates over the period beginning with the Effective Date and ending December 31, 2012.

ii. DISTRIBUTION RATE PLAN

Q. Please provide further information regarding the potential rate adjustments that could take place over the period you just referred to.

A. Beginning with the Effective Date and for a period that ends December 31, 2012, changes in GSEC's distribution rates resulting from the initial $1.1 million rate reduction are limited. Upon the closing of the merger, the GSEC Rate Plan goes into effect for the five-year period January 1, 2008 through December 31, 2012 (the Rate Plan Period). The GSEC Rate Plan provides for the following adjustment and potential adjustments to the distribution rates in effect following the $1.1 million reduction implemented on the Effective Date:

- the second $1.1 million rate reduction (again, this provision is subject only to the Commission's approval of the merger and not the closing of the merger transaction);
- certain exogenous events that occur during the Rate Plan Period;
- approved adjustments to support GSEC's Reliability Enhancement Program; and
- adjustments (if any) to the Storm Contingency Fund.

I will discuss these items in more detail later in my testimony.

You mentioned earlier that the $2.2 million in rate reductions are not contingent upon the closing of the merger, only the Commission's approval of the merger. Are there any other terms of the GSEC Rate Plan that are treated similarly?

A. Yes. The Storm Contingency Fund, the Reliability Enhancement Program and certain commitments in the areas of customer service are contingent only upon the Commission's approval of the merger transaction and not upon the closing of the merger. I will be providing additional details regarding each of these areas later in my testimony.

Q. Why are rate adjustment provisions due to the occurrence of exogenous events permitted?

A. Permitting rate adjustments due to certain exogenous events provides a reasonable balance of risk sharing in exchange for GSEC's agreement to limit changes to its distribution rates for the five-year Rate Plan Period. During the Rate Plan Period, GSEC will be permitted to adjust its rates for large increases and/or decreases to its annual costs due to events beyond its control.

Q. For purposes of the GSEC Rate Plan, what types of events are considered exogenous events?

A. Detailed descriptions are found on pages 4 through 7 of the GSEC Rate Plan. In summary, the covered events include:

- changes in state, local or federal tax or other laws that impose new obligations, or remove or change existing obligations;
  the reassignment of costs to or away from the distribution function by the Commission, the FERC, NEPOOL, the ISO or any other agency having such authority;
- excessive inflation (i.e., average annual inflation in excess of 4%); and
- externally imposed accounting rules.

Q. Is there a certain dollar threshold that must be met for each such exogenous event?

Yes. Each exogenous event, with the exception of excessive inflation, must result in a change of more than $100,000 to GSEC's annual revenue requirement in order for GSEC to file for a rate adjustment.

Q. Is there a limit on how many filings for exogenous event rate adjustments GSEC may make?

A. Yes. The filings are limited to once per calendar year. If more than one such qualifying event occurs in a year, the related amounts shall be deferred for consolidation in a single filing. If such a deferral reaches $150,000, the total deferred cost or credit accrues interest at the rate paid on customer deposits until such time that the cost or credit is reflected in rates.

Q. How does the excessive inflation adjustment provision work?

A. For purposes of the GSEC Rate Plan, excessive inflation is inflation exceeding 4%, as measured by annual changes in the Gross Domestic Product Implicit Price Deflator. The determination of whether actual inflation qualifies as excessive and therefore an exogenous event will require reviewing the annual rates of inflation over two periods of time, the first being the period January 1, 2008 through December 31, 2010 and the second being the period January 1, 2008 through December 31, 2011. If the average annual rate of inflation over those periods exceeds 4%, GSEC will be allowed to file for an increase to its distribution rates to recover additional operation and maintenance expenses (with exceptions for certain reliability and vegetation management expenses). The operation and maintenance expenses allowed will be determined by multiplying the incremental inflation rate above 4% by the actual 2010 and/or 2011 operation and maintenance expenses. Any such adjustments would be effective for calendar year 2011 and/or 2012. Exhibit GSE-5 demonstrates how such an inflation adjustment would be calculated.

Q. Did Staff look at historical and forecasted inflation rates and is Staff comfortable with the use of 4% for purposes of the excessive inflation provision?

A. Yes to both questions. Staff reviewed recent economic publications which indicated that a 4% annual level of inflation is higher than recent historical and currently forecasted inflation rates. Of course, economic conditions can change. However, Staff believes that, for purposes of the GSCE Rate Plan, the use of 4% is reasonable.

Q. Can GSEC file for an exogenous event rate adjustment no matter what its level of earnings?

A. No. If GSEC's earned return on equity for the period beginning January 1, 2008 through the end of the last quarter prior to the date of filing for such an adjustment exceeds 11%, it cannot file for such an adjustment until the average return goes below 11%. If this occurred, GSEC can adjust its rates on a prospective basis only.

iii. MERGER-RELATED COSTS

Q. How does the GSEC Rate Plan treat costs related to the merger?

A. There are essentially two types of costs related to the merger: acquisition premiums and costs to achieve the merger. The GSEC Rate Plan precludes GSEC from including acquisition premiums from this or any prior merger in its distribution cost of service now and in any ratemaking mechanism in the future. Regarding the costs to achieve the merger (which are defined in the GSEC Rate Plan), GSEC shall be allowed to amortize its allocated share of the costs over a ten year period beginning January 1, 2008. Those costs, initially estimated to be slightly more than $2 million, when adjusted to include a reasonable return, result in an annual amortization expense of $262,591. Over the ten year amortization period, GSEC will be tracking the actual costs and reporting them annually to the Commission. The annual amortization amount will be adjusted to reconcile to the costs actually incurred.

iv. CAPITAL STRUCTURE/COST OF CAPITAL.

Q. In the Electric Division's review of GSEC's earnings, what observations were made regarding GSEC's capital structure?

A. GSEC's capital structure has, over time, become heavily weighted with equity. As of the end of 2006, GSEC capital structure included over 80 % equity. A capital structure that is heavy on equity increases costs to customers as equity typically carries a higher cost rate than debt.

Q. What capital structure has been agreed to in the GSEC Rate Plan?

A. For ratemaking and earnings calculation purposes, GSEC shall use an imputed capital structure comprised of 50% equity and 50% debt. The equity is assigned a 9.67% cost rate and the debt carries its embedded cost of 7.54%. On a weighted basis, the overall cost of capital is 8.61%.

Q. How does the 9.67% cost of equity compare to the other New Hampshire regulated electric utilities?

A. The cost of equity in the GSEC Rate Plan is the same rate recently considered by the Commission for the other electric utilities under its jurisdiction. Unitil Energy Systems recently completed a rate case wherein the Commission approved a settlement agreement that, among other things, used the same 9.67% cost rate for equity. Similarly, hearings were recently held on a settlement agreement in a Public Service Company of New

Hampshire (PSNH) rate case that also included a 9.67% cost of equity. The Commission has yet to rule on that case, but I would note that no party offered any opposing testimony on that issue.

v. EARNINGS REPORTS/SHARED EARNINGS MECHANISM

Q. Does the GSEC Rate Plan impose any reporting requirements on GSEC regarding its earnings during the Rate Plan Period?

A. Yes. By May 1st of each year beginning in 2009, GSEC will be required to file an annual earnings report for the prior calendar year. In addition, GSEC will also be required to file an interim accumulated earnings report that calculates the cumulative average return on equity for the period beginning January 1, 2008 through December 31 of the calendar year preceding the May 1st filing. On or by May 1, 2013, GSEC shall file a final accumulated earnings report showing the actual cumulative average return on equity for the entire Rate Plan Period.

Q. What is the purpose of the accumulated earnings reports, especially the final one?

A. The GSEC Rate Plan includes a shared earnings mechanism whereby GSEC will be allowed to retain 100% of any earnings over its allowed return on equity of 9.67%, up to a maximum of 11%, or 1.33% over the allowed return on equity during the Rate Plan Period. If GSEC earns in excess of 11% during the Rate Plan Period, any excess earnings are to be shared 50/50 between customers and GSEC. The determination of how much, if any, earnings are to be shared will be determined following the end of the Rate Plan Period, December 31, 2012, via the final accumulated earnings report. An example of the final accumulated earnings report has been included with the GSEC Rate Plan as Exhibit GSE-6.

Q. What happens if GSEC earns below its allowed return on equity of 9.67%?

A. Any earnings below 9.67% are solely the responsibility of GSEC.

v. STORM CONTINGENCY FUND

Q. Please provide a brief description of the Storm Contingency Fund.

A. This fund operates much like PSNH's Major Storm Cost Reserve. On an annual basis, GSEC shall fund a reserve account in the amount of $120,000. In the event that GSEC experiences a major storm, which for GSEC has been defined as "a severe weather event or events causing 30 concurrent [primary and secondary] troubles and 15% of customers interrupted, or 45 concurrent [primary and secondary] troubles,"[1] it shall be allowed to charge its operation and maintenance costs for that major storm against the reserve account. Interest shall accrue on any positive or negative balance in the reserve at the same rate as the interest rate on customer deposits.

Q. Is there a provision to reexamine the funding level of the Storm Contingency Fund?

A. Yes. After two years from the Effective Date of the GSEC Rate Plan, the Settling Parties and Staff will review the adequacy of the funding level to determine if any changes in the funding level and corresponding adjustments to distribution rates are warranted.

Q. Will GSEC be required to periodically report on activity related to the Storm Contingency Fund?

A. Yes. Beginning April 1, 2009, GSEC will be required to report, for the preceding calendar year, any amounts charged or credited to the Storm Contingency Fund along with a description of each storm, the extent of damage, and the number and length of outages.

vii. RELIABILITY ENHANCEMENT PROGRAM

Q. At the beginning of your testimony you mentioned that Staff had been reviewing GSEC's reliability performance and found that the statistics for certain reliability indices were worsening in recent years. How has that been addressed in the GSEC Rate Plan?

A. First, I should note that GSEC, also aware of the recent degradation in reliability, implemented a multi-year reliability enhancement program during fiscal year 2007. Pursuant to negotiations in this proceeding, the program has been further enhanced and modified. For each fiscal year following the Effective Date of the GSEC Rate Plan, GSEC will implement a Reliability Enhancement Program (REP) and a Vegetation Management Program (VMP). By implementing the REP and VMP, the goal is that by the end of fiscal year 2013 (which begins April 1, 2012 and ends March 31, 2013), GSEC's SAIDI and SAIFI indices will return to levels that existed prior to 2005. Exhibit GSE-8 to the GSEC Rate Plan provides detailed descriptions of the types of capital expenditures and operation and maintenance activities to be performed under the REP and VMP.

Q. Are there provisions for distribution rate adjustments related to REP and VMP spending?

A. Yes. There are separate rate adjustment provisions for O&M and capital spending that I will address in more detail shortly.

Q. Are there base funding levels for the REP and VMP?

A. Yes. For fiscal year 2008, GSEC will implement an aggressive plan with an anticipated total O&M budget for both plans of $1,950,000. If GSEC spends less than that amount during fiscal year 2008, the difference will be carried forward and added to the fiscal year

[1] GSEC Rate Plan, Exhibit GSE-7, page 1.

2009 base O&M spending amount. If GSEC spends more than $1,950,000, it will absorb the excess with no provision for an adjustment to distribution rates. GSEC will also be allowed to make up to $950,000 of REP capital investments during fiscal year 2008.

Q. Please explain how the rate adjustment provision for O&M spending works.

A. For fiscal years 2009 through 2013, the annual base O&M spending for the REP and VMP plans is $1,360,000. GSEC will track and report, by May 15th of each year, the total REP and VMP O&M actual expenses incurred during the prior fiscal year. To the extent that GSEC's actual REP/VMP O&M spending in those years is less than the base amount, the difference shall either be refunded to customers or credited to customers for future REP/VMP O&M expenditures, along with accrued interest at the customer deposit rate, as the Commission determines is appropriate. If the annual O&M spending exceeds the base amount, the incremental expense shall be included in rates, subject to Commission approval. An illustrative example of the computation of revenue requirements for O&M rate adjustment mechanism has been provided in Exhibit GSE-8, Attachment 1, page 2 of 3.

Q. How does the capital spending rate adjustment, i.e., the Capital Investment Allowance, work?

A. A sample calculation for the Capital Investment Allowance can be found in Exhibit GSE-8, Attachment 1, page 3 of 3. GSEC will track and report, by May 15th of each year, all capital investments made in accordance with the REP during the prior fiscal year. Subject to Commission approval, GSEC shall be allowed to increase its distribution rates to recover the annual revenue requirement associated with those capital investments.

Q. Are there any other reporting requirements for the REP and VMP?

Yes. Beginning with fiscal year 2009, GSEC will provide, no later than February 15th, its REP and VMP plans for the upcoming fiscal year to Staff for its review. The plans will itemize the proposed REP and VMP activities for the upcoming year. Taking into account Staff's comments, GSEC will take all reasonable steps to implement the plans. Following each year, GSEC will reconcile the actual expenditures with the targeted spending levels and include the reconciliation in its May 15th annual report described above. Such report will also include an explanation of any deviations from the planned activities as well as the SAIDI and SAIFI results for the prior calendar year.

Q. Is GSEC required to perform any studies related to its distribution system?

A. Yes. Those studies are described on pages 9 and 10 of Exhibit GSE-8 and include the following:

- Whether additional fuse placement, recloser placement and potential splitting of distribution circuits is warranted;
- A vegetation management study that will include, at a minimum, a review of cycle trimming and clearance specifications;
- An analysis of all transmission-related outages that occurred from 1999 through 2006 in each of the three major work areas of GSEC; and
- An analysis of all company-caused human-related outages that occurred from 1999 through 2006 in each of the three major work areas of GSEC.

GSEC shall supply Staff with the results of each of the studies and will detail the actions it will take as a result of the analyses.

viii. CUSTOMER SERVICE COMMITMENTS

Q. Did Staff review GSEC's historical call center performance and customer satisfaction scores?

A. Yes. For the period beginning January 1, 2004 and ending December 31, 2006, an average of 93.6% of calls from GSEC customers were answered within 20 seconds. The customer satisfaction score averaged 90% for the same period.

Q. Are there any changes in store for GSEC's customer information system?

A. Yes. National Grid is in the process of converting its customer information system to a one call resolution model (Customer Service System or CSS). The targeted conversion date is November 2007.

Q. How does the GSEC Rate Plan address customer service issues?

A. The GSEC Rate Plan contains certain commitments by GSEC in the area of customer service. Specifically, prior to the conversion to the CSS system, GSEC will meet or exceed a service level of answering 80% of calls within 20 seconds. For a six month transition period following the conversion, GSEC will meet or exceed a service level of answering no less than 80% of calls within 30 seconds.

Q. Why is the call answering standard different during the transition period?

A. GSEC anticipates that the conversion to the CSS system will have a short term, negative impact on call answering times as time will be needed for customer service representatives to become comfortable with the new systems. The transition period allows time for GSEC to "work the kinks out."

Q. What happens at the end of the transition period?

A. GSEC, the OCA and Staff will meet in the sixth month following the conversion to the CSS system to review the status of the conversion and any associated impacts on service. Staff and the OCA will work with GSEC to develop a more comprehensive set of customer service standards, including any appropriate changes to the service level, once the transition period has ended.

Q. What will the call answering standard be following the transition period?

A. Until a new set of customer service standards has been developed, GSEC's call center performance will meet or exceed 80% of calls answered in 20 seconds.

Q. Under the terms of the GSEC Rate Plan, is GSEC obliged to perform a customer satisfaction survey?

A. Yes. Currently, National Grid conducts annual customer satisfaction surveys of its New York and New England customers. As this is a combined survey, the number of GSEC customers included in the survey is not as large as it would be if the survey was conducted solely for New Hampshire and does not yield a robust sample size. Based on the number of New Hampshire customers surveyed, the survey produces results for New Hampshire that have an error rate of plus/minus 5.7%. Under the terms of the settlement, National Grid will increase the number of GSEC customers surveyed to a level that produces a statistically valid sample size with an error rate of plus/minus 2.5%. With the lower error rate, the 88% customer satisfaction score provided for in the settlement is comparable to the historic customer satisfaction of 90%.

Q. Does Staff have any additional comments regarding customer service?

A. Yes. While it may appear that customer service may be slightly lower than that currently experienced by Granite State customers, allowing Granite State a slightly lower service level while being held to the historic customer satisfaction scores should not produce discernible reductions in the level of customer service. Moving to a one call resolution model, while possibly increasing the length of an individual call, should help keep customer satisfaction at a high level by reducing follow-up calls. Increasing the number of GSEC customers included in the customer satisfaction survey is an added benefit. Additionally, the review of customer service standards in the twelve to twenty-four months following the merger allows for adjustments and corrections to customer service standards, providing further comfort that customer service will not be degraded as a result of the merger.

ix. OTHER PROVISIONS

Q. Do any of the terms of the GSEC Rate Plan live on after the Rate Plan Period ends?

A. Yes. The earnings sharing provision, Storm Contingency Fund and the REP/VMP will remain in effect until the earlier of the conclusion of GSEC's first distribution rate proceeding or the effective date of temporary rates. These mechanisms and programs will remain under the same terms, with the exception being that the earnings sharing will be performed on an annual basis rather than after a five-year period.

V. CONCLUSION

Q. What are your concluding comments?

A. Staff recommends that the Commission approve the Merger Settlement and the terms and conditions of the GSEC Rate Plan as being in the public interest. Pursuant to the agreements, the resulting rates will be just and reasonable and GSEC customers will also gain the benefits of improved reliability and strong customer service.

Q. Does this conclude your testimony?

A. Yes, it does.