

MEMORANDUM

TO: The Rhode Island Public Utilities Commission, Docket 4038

FROM: Bruce R. Oliver, Revilo Hill Associates, Inc.

DATE: March 23, 2015 ((Revised, replaces March 22 Memo)

SUBJECT: National Grid's Request for Modification of its Natural Gas Portfolio Management Plan ("NGPMP")

On March 3, 2015, and as supplemented on March 21, National Grid (hereinafter "National Grid" or "the Company") submitted a "Natural Gas Portfolio Management Plan (GNPMP) Modification Request" with the Rhode Island Public Utilities Commission (hereinafter "RIPUC" or "the Commission"). I have reviewed and analyzed the content and rationales for the Company's request. This memorandum conveys a summary of my review and analysis.

BACKGROUND

Under the provisions of the currently effective NGPMP, National Grid guarantees its Rhode Island firm gas sales service customers a minimum of \$1.0 million per year in benefits from the sharing of net asset management revenues (or asset optimization margins) achieved within each fiscal year (i.e., each period starting with April 1 of a given calendar year and concluding with March 31 of the subsequent calendar year). Once the threshold level of \$1.0 million of net asset management revenue is exceeded within a fiscal year, all incremental net asset management revenue is presently distributed 80% to firm gas sales service customers and 20% to the Company. The Company's 20% participation of realized net asset management revenue is intended to provide an incentive for the Company to maximize the amount of benefit that ratepayers obtain from greater utilization of resources for which they pay, but are not necessary to meet firm gas sales service customers' gas supply requirements for the provision of gas service during some portions of the year.¹

Over the life of this mechanism, which became effective in the Company's 2010 Fiscal Year, the net asset management revenues generated by National Grid through the Company's management of its Rhode Island gas supply portfolio exceeded \$41 million. Of those benefits, over \$34.3 million or 83.0% have accrued to the benefit of Rhode Island ratepayers. Furthermore, the Company's net asset management revenues have

¹ Due to the lumpiness of capacity additions and load growth uncertainties, there may at times be portions of the Company's capacity that is not expected to be utilized in a given year, even under design weather conditions. However, it is expected that the Company would exert best efforts to minimize both: (1) the amount of capacity in excess of firm customers' requirements that is included in the Company's portfolio of gas supply and storage assets; and (2) the duration of periods during which significant excesses are experienced.

consistently exceeded the \$1.0 million threshold. The historical sharing of NGPMP benefits is shown in Table 1 below.

Table 1
Historical Sharing of NGPMP Benefits

| Year | Total Net Asset Mgmt Revenue | Ratepayer Benefits | | Company Benefits | |
|------|------------------------------------|--------------------|---------------|------------------|---------------|
| | | \$ | % of Total | \$ | % of Total |
| 2010 | \$ 2,876,378 | \$2,501,102 | 87.0% | \$ 375,276 | 13.0% |
| 2011 | \$ 4,655,474 | \$3,924,380 | 84.3% | \$ 731,094 | 15.7% |
| 2012 | \$ 5,498,991 | \$4,599,192 | 83.6% | \$ 899,798 | 16.4% |
| 2013 | \$ 8,412,857 | \$6,930,285 | 82.4% | \$1,482,571 | 17.6% |
| 2014 | \$ 8,370,836 | \$6,896,669 | 82.4% | \$1,474,167 | 17.6% |
| 2015 | \$11,547,657 | \$9,468,126 | 82.0% | \$2,079,531 | 18.0% |

THE COMPANY'S PROPOSAL

Following discussions with the Division, National Grid proposes to modify the current NGPMP revenue sharing in a manner that would provide greater sharing benefits to ratepayers as the annual level of net asset management revenues increases. It would eliminate the requirement that the Company guarantee a minimum level (\$1,000,000) of benefit to its firm gas sales service customers. Thus, the Company would no longer be required to pay sharing benefits to ratepayers that are not supported by actually achieved levels of net asset management revenue, and that removes a risk that the Company presently faces. The initial block, though, for which ratepayers would receive 100% of achieved benefits is expanded from \$1.0 million to \$2.0 million for each fiscal year, and the sharing percentages for ratepayers for achieved net asset management revenue in excess of \$5.0 million per year are increased under the proposed modification. Table 2 provides a side-by-side comparison of the current sharing arrangement with the Company's proposal in this proceeding.

Table 2
Comparison of Current and Proposed NGPMP
Sharing Percentages for Net Asset Management Revenue

| Annual Net Asset Mgmt Revenue | <u>Current Sharing %</u> | | <u>Proposed Sharing %</u> | |
|--|---------------------------------|-----------------------|----------------------------------|-----------------------|
| | <u>Ratepayers</u> | <u>Company</u> | <u>Ratepayers</u> | <u>Company</u> |
| 0 to \$1.0 Million | 100% | 0% | 100% ² | 0% |
| >\$1.0 Million to \$2.0 Million | 80% | 20% | 100% | 0% |
| >\$2.0 Million to \$5.0 Million | 80% | 20% | 80% | 20% |
| >\$5.0 Million to \$10.0 Million | 80% | 20% | 90% | 10% |
| >\$10.0 Million | 80% | 20% | 94% | 6% |

ANALYSIS OF COMPANY PROPOSAL

At very low levels of net asset management revenue (i.e., margins on asset optimization activities below \$1.0 million) the Company is required under the current NGPMP to make payments to ratepayers that are not supported by revenues actually achieved. The NGPMP the Company proposes in its March 3, 2016 filing eliminates the risk to National Grid that it might be required to make payments to ratepayers that are not supported by realized net asset management benefits. As shown in Table 1, the Company's actual net asset management revenues have substantially exceeded the \$1.0 million threshold in each since the NGPMP became effective.

If the procedure for sharing NGPMP benefits that National Grid proposes in its March 31, 2016 filing, had been in effect for each of the Company's last five fiscal years, the benefits derived from the operation of the NGPMP for National Grid's customers would have been greater. Table 3 illustrates the results that would have resulted for Rhode Island ratepayers if the Company's proposed NGPMP sharing arrangement had been applied to the Company's actual net asset management revenues for each of the last five years.

² Company guarantees a minimum of \$1.0 million of benefit for ratepayers regardless of whether the actual amount of achieved net asset management revenues falls below \$1.0 million for any fiscal year.

Table 3
Sharing of NGPMP Benefits for FY 2010 Through FY 2015
Recast to Reflect National Grid's Proposed Sharing Arrangement³

| Year | Total Net Asset Mgmt <u>Revenue</u> | <u>Ratepayer Benefits</u> | | <u>Company Benefits</u> | |
|------|---|---------------------------|-----------------------|-------------------------|-----------------------|
| | | <u>\$</u> | <u>% of Total</u> | <u>\$</u> | <u>% of Total</u> |
| 2010 | \$ 2,876,378 | \$ 2,701,102 | 93.9% | \$ 175,276 | 6.1% |
| 2011 | \$ 4,655,474 | \$ 4,124,379 | 88.6% | \$ 531,095 | 11.4% |
| 2012 | \$ 5,498,991 | \$ 4,849,092 | 88.2% | \$ 649,899 | 11.8% |
| 2013 | \$ 8,412,857 | \$ 7,471,571 | 88.8% | \$ 941,286 | 11.2% |
| 2014 | \$ 8,370,836 | \$ 7,433,752 | 88.8% | \$ 937,084 | 11.2% |
| 2015 | \$11,547,657 | \$10,354,797 | 89.7% | \$ 1,192,859 | 10.3% |

Table 4 demonstrates that, if the Company's proposed NGPMP sharing formula had been in place over the last six years, Rhode Island ratepayers would have received an additional \$2.6 million of benefits (i.e., credits against gas costs).

Table 4
Historical Results Recomputed
Using National Grid's Modified NGPMP Proposal

| Year | <u>Ratepayer Share Current NGPMP</u> | <u>Ratepayer Share Proposed NGPMP</u> | <u>Increase in Ratepayer Share</u> |
|-------|--|---|--|
| 2010 | \$ 2,501,102 | \$ 2,701,102 | \$ 200,000 |
| 2011 | \$ 3,924,380 | \$ 4,124,379 | \$ 200,000 |
| 2012 | \$ 4,599,192 | \$ 4,849,092 | \$ 249,900 |
| 2013 | \$ 6,930,285 | \$ 7,471,571 | \$ 541,286 |
| 2014 | \$ 6,896,669 | \$ 7,433,752 | \$ 537,083 |
| 2015 | \$ 9,468,126 | \$10,354,797 | \$ 886,671 |
| Total | \$34,319,753 | \$36,934,693 | \$2,614,940 |

³ Under the NGPMP asset optimization revenues that result from third-party management arrangements are not subject to sharing. Rather, the Commission has determined that those revenues are credited 100% to ratepayers. However, for simplicity and ease of recalculation, this analysis assumes that all asset optimization revenues are subject to sharing under the proposed sharing percentages set forth by National Grid in its proposal. This simplifying assumption is not perceived to have a substantial impact on the overall results of the analyses presented, as the revenues from third party management activities have historically been a comparatively small component of total net asset management revenue on an annual basis.

It should be remembered, however, that any credits or benefits received by ratepayers represent partial compensation for costs of otherwise unused or partially unused capacity resources that are included in the Company's costs of gas. This is particularly important in the context of National Grid's addition of a significant increment to its gas supply resources through its participation in the Tennessee Gas Pipeline Northeast Direct (NED) Project. Since pipeline capacity additions are "lumpy" and not easily matched to a company's anticipated needs for additional capacity in any given year, the Company's planned addition of NED project capacity could result in ratepayers bearing added costs for pipeline capacity that may not be required for several years. The addition of the NED project capacity increases the likelihood that the Company will have greater pipeline resources to market to third parties as part of its asset optimization activities, and that greater availability of capacity to market to third parties increases the potential that National Grid's net asset management revenue in the coming years will exceed the levels the Company achieved in recent years.

Over the period the NGPMP has been in place the Company's annual sharing of benefits from its asset optimization activities has grown from about \$375,000 to over \$2.0 million. Although some of that increase can be attributed to the Company's management of capacity resources in its Rhode Island gas portfolio, other factors beyond the Company's control have also added to the magnitude of the net benefits derived from the management of those assets. Among those factors are extreme weather during recent winter periods and significant growth in the use of natural gas in New England for electric generation, which have added value to the capacity available for release.

CONCLUSION

Based on the foregoing analysis, the Company's proposed modification of its NGPMP sharing mechanism appears reasonable and in the best interests of ratepayers. It will provide greater benefits to ratepayers while still maintaining reasonable incentive for the Company to continue to maximize asset optimization benefits for ratepayers.