

February 23, 2009

VIA HAND DELIVERY & ELECTRONIC MAIL

Luly E. Massaro, Commission Clerk
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02889

**RE: Natural Gas Portfolio Management Plan
Docket No. _____**

Dear Ms. Massaro:

Attached is an original and nine copies of a detailed “Natural Gas Portfolio Management Plan” (“NGPMP”) through which the Company and the Division propose to institute changes to the current gas portfolio management plan in Rhode Island. These proposed changes are designed to provide various financial, regulatory, and risk management benefits over the current asset management arrangement. In support of the NGPMP, the Company is also submitting an original and nine copies of the pre-filed testimony of Stephen A. McCauley, Elizabeth Danehy Arangio, and Gary L. Beland. This filing also contains a Motion for Protective Treatment in accordance with Rule 1.2(g) of the Commission’s Rules of Practice and Procedure and R.I.G.L. § 38-2-2(4)(B). The Company seeks protection from public disclosure of certain confidential, commercially sensitive, and proprietary asset management fees and bid responses referred to in the testimony of Stephen A. McCauley. Accordingly, National Grid requests that the Commission protect the confidentiality of that information. To that end, the Company has provided the Commission with one copy of the confidential materials for its review, and has otherwise included redacted copies of Mr. McCauley’s testimony in the filing.

The NGPMP is designed to encourage the Company to minimize gas costs to customers by combining a least-cost dispatch, which applies an index price formula, as the Company does today, with an asset optimization program designed to obtain the maximum value from the Rhode Island gas supply portfolio resources. This would be accomplished by the Company’s taking control of the gas portfolio assets in order to actively manage and optimize the value of that portfolio.

The NGPMP includes the following significant aspects:

- The Company will discontinue contracting with an asset manager as a full outsource supplier and will undertake the functions previously performed by the asset manager using Company resources.
- Under the NGPMP revenue sharing provisions, Rhode Island customers will be guaranteed an annual gas cost optimization benefit of \$1 million during the twelve-month period commencing each April 1. In addition, Rhode Island customers will receive 80% of all net proceeds above the first \$1 million, with the Company receiving 20%.

- After the Company has met the load requirements of the Rhode Island customers through least cost dispatch of all assets, the Company will dedicate its internal resources to recognize and realize arbitrage and optimization opportunities by structuring a combination of transactions using the portfolio of assets and its flexibility to take advantage of opportunities that arise in the market place.
- The NGPMP will not affect the Gas Purchase Incentive Plan (“GPIP”) in any way. Because the GPIP utilizes the purchase of future contracts for hedging, the two plans will be independent.
- The NGPMP contains quarterly and annual reporting requirements that will provide transparency in measuring the Company’s performance under the NGPMP.
- The Company’s performance will be measured against standards that were applied to the current third-party asset manager.

The NGPMP will mitigate or remove the risks associated with a third-party’s manager’s financial condition, particularly in the historically depressed financial climate in which we are now operating. It will also enable full compliance and greater flexibility under FERC regulations relative to title and release limits. In addition to these advantages, the NGPMP comes with the additional advantage of the potential reduction to Rhode Island customers’ gas costs through the plan’s revenue sharing mechanism.

The Company and the Division have worked together to produce the NGPMP and are in agreement in their support of this filing. Because the current asset management arrangement in Rhode Island expires on April 1, 2009, the Company respectfully requests an expeditious process for Commission consideration of this proposed plan.

The Company has also enclosed a draft notice that will be published in the *The Providence Journal* to notify the public of the filing. The Company will publish this notice after receiving a docket number for this filing from the Commission.

Thank you for your attention to this transmittal. If you have any questions, please feel free to contact me at (401) 784-7667.

Very truly yours,



Thomas R. Teehan

Enclosures

cc: Paul Roberti, Esq.
Steve Scialabba, Division

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

RHODE ISLAND PUBLIC UTILITIES COMMISSION

_____)
National Grid)
Natural Gas Portfolio Management) Docket No. _____
Plan)
_____)

**MOTION OF THE NARRAGANSETT ELECTRIC COMPANY,
D/B/A NATIONAL GRID
FOR PROTECTIVE TREATMENT OF CONFIDENTIAL INFORMATION**

Now comes The Narragansett Electric Company, d/b/a National Grid (“Company”) and hereby requests that the Rhode Island Public Utilities Commission (“Commission”) grant protection from public disclosure of certain confidential, competitively sensitive and proprietary information submitted in this proceeding, as permitted by Commission Rule 1.2(g) and R.I.G.L. § 38-2-2(4)(i)(B).

I. BACKGROUND

On February 23, 2009, the Company filed with the Commission its proposed Natural Gas Portfolio Management Plan. This filing contains testimony that includes references to portfolio management fees agreed to by Merrill Lynch and ConocoPhillips under the terms of Rhode Island portfolio-management contracts. In addition, the Company is providing information on the results of its asset management RFP in Massachusetts and Rhode Island. This information is competitively sensitive, proprietary information that the Company has agreed to keep confidential.

For the reasons stated below, the Company requests that this information be protected from public disclosure. The Company has filed redacted copies of page 7 of the testimony of Stephen A. Mc Cauley, deleting references to the portfolio management fees and the RFP results in accordance with the confidentiality provisions the Company has under both the portfolio-management contracts and the RFP agreement.

II. LEGAL STANDARD

Rule 1.2(g) of the Commission's Rules of Practice and Procedure provides that access to public records shall be granted in accordance with the Access to Public Records Act ("APRA"), R.I.G.L. §38-2-1, *et seq.* Under APRA, all documents and materials submitted in connection with the transaction of official business by an agency is deemed to be a "public record," unless the information contained in such documents and materials falls within one of the exceptions specifically identified in R.I.G.L. §38-2-2(4). Therefore, to the extent that information provided to the Commission falls within one of the designated exceptions to the public records law, the Commission has the authority under the terms of APRA to deem such information to be confidential and to protect that information from public disclosure.

In that regard, R.I.G.L. §38-2-2(4)(i)(B) provides that the following records shall not be deemed public:

Trade secrets and commercial or financial information obtained from a person, firm, or corporation which is of a privileged or confidential nature.

The Rhode Island Supreme Court has held that the determination as to whether this exemption applies requires the application of a two-pronged test set forth in Providence Journal Company v. Convention Center Authority, 774 A.2d 40

(R.I.2001). The first prong of the test assesses whether the information was provided voluntarily to the governmental agency. Providence Journal, 774 A.2d at 47. If the answer to the first question is affirmative, then the question becomes whether the information is “of a kind that would customarily not be released to the public by the person from whom it was obtained.” Id.

In addition, the Court has held that the agencies making determinations as to the disclosure of information under APRA may apply the balancing test established by the Court in Providence Journal v. Kane, 577 A.2d 661 (R.I.1990). Under this balancing test, the Commission may protect information from public disclosure if the benefit of such protection outweighs the public interest inherent in disclosure of information pending before regulatory agencies.

III. BASIS FOR CONFIDENTIALITY

The Company seeks to protect from public disclosure the terms contained in its asset management agreement with Merrill Lynch and its prior agreement with ConocoPhillips. Additionally, the Company seeks to protect from disclosure information related to amounts bid by parties to the Company’s RFP relative to Rhode Island and its RFP relative to Massachusetts. Merrill Lynch and ConocoPhillips, as well as the bidders in those RFPs, are active participants in the gas marketplace and require confidential treatment of the price terms set forth in their asset management contracts in order to protect their competitive positions, bargaining latitude and negotiating leverage in the marketplace.

The key consideration, consistent with the Commission’s rules and precedent, is that public disclosure of these terms would be commercially harmful to Merrill Lynch,

ConocoPhillips, and the above-referenced bidders because other customers and potential customers could use this information to seek similar terms. Also, their competitors would have obtained important, competitively sensitive information, which would give those competitors an unfair competitive advantage. In addition, the fees contained in the asset management arrangements are subject to confidentiality provisions. Similarly, when seeking bids under an RFP, the Company also provides an assurance of confidentiality to bidders in order to encourage them to provide their best bid.

Moreover, disclosure would potentially impede the Company's ability to obtain a similar or better arrangement from other potential portfolio managers in the future, to the detriment of customers. In short, all of the information for which the Company is seeking confidential treatment, the Merrill Lynch and ConocoPhillips asset management fees and the RFP results in Massachusetts and Rhode Island, must remain confidential to preserve the Company's future negotiating leverage and its ability to function effectively in a competitive gas-supply marketplace. A lack of confidential treatment may discourage potential portfolio managers from making bids or agreeing to specific provisions more favorable to the buyer because public knowledge of such information would decrease the managers' bargaining leverage in other negotiations.

V. CONCLUSION

The portfolio management fees agreed to by Merrill Lynch and ConocoPhillips under the terms of their portfolio-management contracts and the RFP results in Massachusetts and Rhode Island are confidential, commercially sensitive, and proprietary. Disclosure on the public record of such pricing information would be detrimental to the public interest in that it would negatively affect the parties' future

bargaining positions and have a negative impact on the marketplace by dissuading potential portfolio managers from providing these services in Rhode Island.

WHEREFORE, the Company respectfully requests that the Commission grant its Motion for Protective Treatment as stated herein.

Respectfully submitted,

**THE NARRAGANSETT ELECTRIC
COMPANY**

By its attorney,



Thomas R. Teehan (RI #4698)
280 Melrose Street
Providence, RI 02907
(401) 784-7667

Dated: February 23, 2009

DIRECT TESTIMONY

OF

STEPHEN A. Mc CAULEY

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EXHIBITS

SAM-1 Natural Gas Portfolio Management Plan

SAM-2 Illustration – Net Proceeds Sharing

1 **I. INTRODUCTION**

2

3 **Q. PLEASE STATE YOUR FULL NAME AND BUSINESS ADDRESS.**

4 A. My name is Stephen A. McCauley and my business address is 100 East Old Country
5 Road, Hicksville, New York.

6 **Q. PLEASE STATE YOUR BUSINESS POSITION AND RESPONSIBILITIES.**

7 A. I am Director of Origination in the Energy Portfolio Management organization. As
8 Director, I am responsible for all financial hedging activity for the eight National Grid
9 regulated utilities. I am also responsible for structuring and optimizing the natural gas
10 assets to help return the most value to the regulated entities.

11 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

12 A. I graduated from the United States Merchant Marine Academy in 1984 with a Bachelor
13 of Science degree in Marine Engineering Systems.

14 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.**

15 A. I joined the Company in 1992 as an engineer for the gas peak shaving plants and the gas
16 regulator and telemetering stations. In 1996, I joined the gas supply group as a trader
17 responsible for purchasing the natural gas supply requirements for both the firm gas
18 customers and the LILCO generation facilities. In 1999, my responsibilities were
19 changed to managing the emissions allowance portfolio and the financial hedging

1 activities of the regulated utilities. In 2002, I was promoted to my current position as
2 Director.

3 **II. PURPOSE OF THE TESTIMONY OF NATURAL GAS PORTFOLIO MANAGEMENT PLAN**

4 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

5 A. The purpose of my testimony is to explain why it is in the best interest of Rhode Island
6 customers for the Commission to approve the Natural Gas Portfolio Management Plan
7 (“NGPMP”) that has been submitted as Exhibit SAM-1. Under the NGPMP, National
8 Grid will in-source those gas portfolio optimization management activities that are
9 currently performed by Merrill Lynch under an existing asset management contract.
10 My testimony will address the various physical, financial, regulatory, and risk
11 management benefits to Rhode Island customers that the NGPMP will provide. I will
12 also describe the optimization strategies that the Company may employ and the methods
13 the Company proposes to implement to measure its performance under the NGPMP.

14 **Q. BRIEFLY STATED, WHAT ARE THE OBJECTIVES OF THE NGPMP THAT IS BEING**
15 **PROPOSED?**

16 A. The NGPMP is designed to encourage the Company to minimize gas costs to customers
17 by combining a least-cost dispatch pursuant to an index price formula, as the Company
18 does today, with an asset optimization program designed to obtain the maximum value
19 from the gas supply portfolio resources. The combination of these processes can be
20 accomplished by the Company taking control of the gas portfolio assets and actively
21 managing to optimize the portfolio.

1 **III. COMPARISON OF THE NGPMP TO THE EXISTING ARRANGEMENT**

2 **Q. PLEASE DESCRIBE HOW THE EXISTING RHODE ISLAND GAS ASSET MANAGEMENT**
3 **ARRANGEMENT CURRENTLY WORKS.**

4 A. Today, the Rhode Island natural gas portfolio is out-sourced to an asset manager,
5 Merrill Lynch, under a one-year contract which expires on March 31, 2009. Subject to
6 considerations of system reliability, the assets within the portfolio are nominated and
7 scheduled to meet the firm sales customers' consumption needs on a least cost basis.
8 Only in the case where the use of an asset, such as LNG or storage, might compromise
9 future system reliability would that not be the case. Thus, the portfolio manager's
10 primary role is to provide reliable, low-cost supplies to Rhode Island customers. In
11 addition, the portfolio manager has an opportunity to capture additional value by further
12 optimization such as making use of assets not needed during a particular day or month
13 or by taking advantage of market opportunities created by changes in pricing.

14 Currently, Merrill Lynch purchases gas for Rhode Island customers based on projected
15 consumption provided to it by National Grid. The Company notifies Merrill of its
16 projected needs both for its baseload supply for the upcoming month and also each day
17 for the next gas day. The contract with Merrill provides a least-cost dispatch order for
18 procurement of supply from all the various sources included in the contract. Merrill
19 then procures and delivers the nominated supply. The price that Rhode Island
20 customers pay for the nominated supplies is based on the published index at each of the
21 receipt point locations dictated by the least cost dispatch order set forth in the contract.
22 Merrill Lynch then optimizes the portfolio of supply and assets to lock in additional

1 value. Under the asset management agreement, Merrill provides customers a fixed
2 optimization value for the contract year. Merrill then retains all of the incremental
3 value that it creates through optimizing the purchase of supply using the portfolio and
4 other supply options.

5 **Q. WHAT GAS PORTFOLIO ASSETS ARE AVAILABLE TO OPTIMIZE?**

6 A. There are several types of assets available within the portfolio. The Company can use
7 its transportation contracts, its underground storage contracts, its peaking supplies, and
8 its Distrigas Firm Combination Service (“FCS”) contract. These assets can be used to
9 optimize the purchase and dispatch of gas supplies in a number of ways. Among the
10 transportation contracts, there are many paths along which to source gas, each of which
11 yields a different citygate-delivered commodity cost. Similarly, each of the
12 underground storage facilities also involves varying delivery paths and associated costs.
13 Lastly, the peaking supplies and the Distrigas FCS contract have their own delivered
14 costs. This mix of supply contracts, transportation contracts, and storage options
15 creates a great deal of flexibility and opportunities for optimization to create value for
16 Rhode Island customers. This potential optimization value is subject to market
17 variables: the fluctuation of gas pricing, the value of temporarily unused assets, the
18 existence of excess transportation and storage capacity and the opportunities to optimize
19 delivered supplies as storage fill opportunities arise.

1 **Q. PLEASE COMPARE THE BENEFITS FOR RHODE ISLAND CUSTOMERS OF THE NGPMP**
2 **TO THE EXISTING ASSET MANAGEMENT ARRANGEMENT.**

3 A. National Grid believes that the NGPMP is more beneficial to Rhode Island customers
4 than the existing out-source arrangement. First, and foremost, the NGPMP returns the
5 Company, after many years, to the role of actively managing the natural gas portfolio.
6 In these perilous financial times, the NGPMP enables the Company to develop and
7 maintain an experienced staff to manage the Rhode Island customers' portfolio. Active
8 asset management by National Grid reduces the risk of performance failure by a third-
9 party manager in the event of financial distress or a decision by the entity to return to its
10 core business and discontinue providing asset management services.

11 **Q. PLEASE DESCRIBE THE IMPORTANCE OF MAINTAINING AN EXPERIENCED STAFF.**

12 A. Under the existing asset management agreement the portfolio is managed by an outside
13 asset manager. Under this type of an arrangement, National Grid is no longer actively
14 participating in the day-to-day management of the portfolio and therefore loses the
15 market intelligence, contractual relationships with gas suppliers and staff experience
16 required to best meet the future needs of the customers. This type of an arrangement
17 inevitably forces the Company into a position where we can no longer maintain the core
18 competency of the day-to-day management of the portfolio.

19 **Q. PLEASE ADDRESS THE PERFORMANCE RISKS ASSOCIATED WITH OUTSOURCING THE**
20 **PORTFOLIO.**

21 A. National Grid has been exposed to third-party asset managers, including Merrill Lynch,
22 who have experienced financial distress and have chosen to either leave the business or

1 seek a partner with a stronger financial condition. By having the portfolio out-sourced
2 to one asset manager, customers rely on the performance of that entity to meet all of the
3 customer's requirements. By National Grid taking control of the Rhode Island
4 customers' gas assets and performing most or all of the portfolio management
5 functions, reliability risk is diversified among many market participants and the failure
6 of one party would be manageable.

7 **Q. PLEASE GIVE AN EXAMPLE OF A POTENTIAL RISK TO RHODE ISLAND CUSTOMERS IN**
8 **THE EVENT OF A THIRD-PARTY ASSET MANAGER IN FINANCIAL CRISIS.**

9 A. Under the current arrangement, the out-source manager must take title to gas held in
10 storage to meet Rhode Island's peak demands as a means to comply with FERC
11 regulations. The reliance on a single supplier, as is the case in an outsourced portfolio,
12 subjects the customers to the bankruptcy risk of that one entity. In the event of a
13 bankruptcy filing by the out-source manager, control of the gas in storage may lie in the
14 hands of a bankruptcy judge. This raises a question as to the timely ability to call upon
15 such gas when needed to meet peak demand. Under the NGPMP, National Grid will
16 control the portfolio and will be able to actively mitigate such risk.

17 **Q. PLEASE COMPARE THE FINANCIAL BENEFITS OF THE NGPMP TO THE CURRENT**
18 **ARRANGEMENT FOR RHODE ISLAND CUSTOMERS.**

19 A. National Grid believes that the financial benefits under the NGPMP will be comparable,
20 and potentially could exceed, the financial benefits under a full out-source arrangement.

1 Q. PLEASE EXPLAIN.

REDACTED

2 A. Under the current out-source arrangement, Rhode Island customers receive an annual
3 fixed guarantee credit to gas costs of \$ [REDACTED] million. The \$ [REDACTED] million guarantee, which
4 expires on March 31, 2009, was determined through a bidding process. This bid
5 guarantee reflected a change in the natural gas markets from the prior 12-month period
6 ending March 31, 2008, which had been \$ [REDACTED] million. Rhode Island customers receive
7 no additional benefit from the value of the portfolio.

8 The Company recently issued a request for proposals (RFP) based upon the co-
9 management of the Rhode Island portfolio by National Grid, as an active asset manager,
10 along with the selected bidder. For purposes of the RFP, potential asset managers were
11 directed to bid a customer guarantee assuming that Rhode Island customers would
12 receive 50% of the realized value of the portfolio that exceeded the customer guarantee
13 and the balance would be shared equally between the co-managers. National Grid
14 received annual guarantee bids ranging between \$ [REDACTED] million and \$ [REDACTED] million with a
15 median bid of \$ [REDACTED] million. Although not an apples-to-apples comparison with the
16 current arrangement, the bids received indicate a current pricing environment that
17 provides a predicted value of the portfolio that is substantially lower than the current
18 year and is back to levels experienced in prior years. Such results are consistent with
19 National Grid's RFP results conducted for its Massachusetts portfolio for the same time
20 period. Using the identical sharing structure for Massachusetts and Rhode Island, the

1 median bid for a portfolio that is approximately three times the size of the Rhode Island
2 portfolio was just \$ million.

3 Under the NGPMP, National Grid will provide Rhode Island customers with a
4 guarantee credit of \$1 million. For all of the net proceeds realized above the \$1 million
5 guarantee, Rhode Island customers will receive 80% of the financial benefit with
6 National Grid receiving 20% of the incremental benefit derived through optimization of
7 the assets. Because National Grid will be executing many of the same optimization
8 strategies as the third party asset managers, it is expected that the Company will realize
9 comparable value by optimizing the portfolio for Rhode Island customers. I have
10 provided an illustration of how the Rhode Island customer will financially benefit as the
11 realized value of the portfolio grows. See Exhibit SAM-2.

12 **Q. PLEASE EXPLAIN WHY YOU SAY THAT RHODE ISLAND CUSTOMERS MAY RECEIVE**
13 **GREATER FINANCIAL BENEFIT FROM THE NGPMP THAN FROM THE CURRENT**
14 **ARRANGEMENT.**

15 A. As I mentioned previously, the financial benefit to Rhode Island customers is currently
16 capped at the value of the fixed guarantee. Under the NGPMP, Rhode Island customers
17 received 80% of all net proceeds above the \$1 million guarantee credit. Therefore, if
18 market conditions change in a manner that enhances the realizable value of the
19 portfolio, Rhode Island customers will continue to enjoy the financial benefit without
20 having had their benefits capped.

21

1 **Q. HOW DOES THE PROPOSED SHARING BETWEEN THE CUSTOMERS AND NATIONAL GRID**
2 **COMPARE TO OTHER NATIONAL GRID UTILITIES?**

3 A. National Grid has different sharing mechanisms in each of its other jurisdictions. In
4 Massachusetts, National Grid's customers receive 50% of the net proceeds realized
5 above a fixed guarantee. In New York, National Grid's customers receive 85% of the
6 net proceeds realized from portfolio optimization without the Company being at risk for
7 providing a fixed guarantee.

8 **Q. PLEASE DESCRIBE THE BENEFIT TO RHODE ISLAND CUSTOMERS PROVIDED BY THE**
9 **NGPMP AS IT RELATES TO COMPLIANCE WITH FERC REGULATIONS.**

10 A. The FERC rules on capacity release, shipper must have title, the prohibition against
11 buy-sell transactions, among others, are all designed to prevent market abuses and
12 create transparency and a competitive market place. But they have also had the effect
13 of creating potential violations under an asset management arrangement. While
14 FERC's recently issued Order 712 allows for asset management arrangements, these
15 rules nevertheless can have the effect of limiting an external asset manager's ability to
16 optimize the value of certain assets. By actively managing the portfolio, National Grid
17 can ensure full compliance with FERC regulations

18 **Q. PLEASE DESCRIBE HOW THE NGPMP PROVIDES GREATER TRANSPARENCY FOR**
19 **RHODE ISLAND CUSTOMERS THAN AN OUT-SOURCE ARRANGEMENT WITH RESPECT TO**
20 **PORTFOLIO OPTIMIZATION ACTIVITY.**

21 A. The NGPMP provides the same transparency with respect to gas procurement for Rhode
22 Island customers as the current out-source arrangement. As addressed throughout my
23 testimony, National Grid does not propose any modification to the least cost purchase

1 dispatch formula that is currently in effect. However, the NGPMP provides greater
2 transparency with respect to the execution of the optimization transactions and the
3 realized value of the optimized portfolio. Currently, neither the actual purchase
4 transactions for the gas customers, nor the optimization transactions performed by the
5 out-source asset manager are visible to National Grid under today's outsource
6 arrangement. Because the asset manager keeps all of the realized value after providing
7 a fixed guarantee to customers, only the asset manager has knowledge of how much
8 value was realized from the portfolio during the contract year. Under the NGPMP,
9 National Grid will be filing quarterly reports of the portfolio's realized value as well as
10 an annual report of the benefits sharing. From these reports, the realized value of the
11 portfolio will be wholly transparent. Additionally, all of the Company's optimization
12 transactions will be subject to audit.

13 **IV. WORKING PROVISIONS OF THE NGPMP**

14 **Q. HOW WILL THE NGPMP WORK?**

15 A. The NGPMP will become effective April 1, 2009, when the current asset management
16 contract with Merrill expires. It will be reviewed with each Gas Cost Recovery
17 ("GCR") filing. The Company will file its report on the plan on June 1 of each year
18 showing the results of the plan for the 12 month period, April 1 through March 31. The
19 benefits under the plan will then be shared by the Company and its customers.

1 **Q. HOW WILL THE COMPANY'S SHARING OF BENEFITS BE DETERMINED?**

2 A The Company will receive a sharing of the benefits under the plan only to the extent
3 that it is able to realize net optimization proceeds in excess of the \$1 million fixed
4 guarantee to Rhode Island customers, thereby reducing gas costs below the level that
5 would have been obtainable through purchasing under the pre-determined least cost
6 purchase dispatch order and ratable storage fill plan.

7 **Q. PLEASE DESCRIBE THE REVENUE SHARING PROVISIONS OF THE PLAN IN MORE DETAIL.**

8 A. As discussed earlier, the Company will guarantee a gas cost optimization credit to
9 Rhode Island customers of \$1 million, regardless of the total net proceeds actually
10 realized from optimizing the portfolio during the twelve-month period commencing
11 April 1. Rhode Island customers will receive 1/12th of the \$1 million guarantee in each
12 month. The remaining revenue sharing benefit to the customers will be applied to
13 reduce amounts in the Company's GCR filing, which is currently made September 1 of
14 each year. Those additional net proceeds will be shared with the Company. Rhode
15 Island customers will receive 80% of all net proceeds above the first \$1 million and the
16 Company will receive 20% of the net proceeds above the first \$1 million.

17 **Q. HOW WILL THE OPTIMIZATION BENEFIT BE CALCULATED?**

18 A. The benefit will be calculated annually to reflect the optimization activity that occurs
19 during the year. For the purposes of revenue sharing, the amount of the net benefits will
20 be calculated by subtracting the actual cost to procure all supplies from the sum of the
21 revenue associated with the optimization transactions and the benchmark cost to

1 provide the supply needed to serve the Company's Rhode Island customers, calculated
2 assuming the least cost dispatch and storage fill.

3 **Q. PLEASE DESCRIBE WHAT IS MEANT BY ACTUAL COSTS TO PROCURE?**

4 A. Actual costs to procure include the cost of all supplies purchased and any variable
5 charges associated with those purchases. Variable costs are the incremental costs that
6 are incurred associated with the purchase, delivery, and storage of supplies needed to
7 meet either customer or third party sale requirements. Examples of variable costs are
8 but not limited to; transportation or storage unit commodity charges, finance costs for
9 incremental storage inventory, finance costs for margin calls, pipeline park and loan
10 fees and broker or exchange transaction fees.

11 **Q. WILL THE NGPMP RETAIN THE INDEX PRICING MEASURES THAT ARE CURRENTLY**
12 **USED IN DETERMINING MERRILL'S PERFORMANCE UNDER THE ASSET MANAGEMENT**
13 **AGREEMENT?**

14 A. Yes. As is currently the case, the Company will establish a least cost dispatch by
15 matching the index price order with the available assets for each month. This process is
16 described in detail in Exhibit SAM-1.

17 **Q. HOW WILL THE FUNCTIONS NEEDED TO IMPLEMENT THE NGPMP BE PERFORMED BY**
18 **NATIONAL GRID?**

19 A. The calculation of the monthly and daily supply requirements for baseload and daily
20 nominations would continue to be performed by National Grid's Gas Supply Planning
21 team, under the supervision of Elizabeth Arangio, as described in Ms. Arangio's
22 testimony. The procurement, scheduling and optimization activities will be performed

1 by National Grid's Energy Transactions team. Both departments are part of National
2 Grid's Energy Portfolio Management group, which currently performs the gas supply
3 planning and asset management services for gas customers in New York, Massachusetts
4 and New Hampshire.

5 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

6 **A.** Yes, it does.

National Grid
Natural Gas Portfolio Management Plan

Effective April 1, 2009

I. Objectives

To encourage the Company to minimize gas costs to customers by coupling a least-cost dispatch with an asset optimization program designed to obtain the maximum value from the gas supply portfolio resources.

II. Structure of the Incentive Plan (“Plan”)

- A. This Plan will become effective April 1, 2009. It will be reviewed with each Gas Cost Recovery (GCR) filing. The Company will file its Report on the Plan on June 1st each year showing the results of the Plan for the prior year, April 1 to March 31.
- B. Under this Plan, the Company will discontinue contracting with an asset manager as a full outsource supplier and will undertake the functions previously performed by the asset manager using Company resources.
- C. To measure the Company’s performance under the Plan and the benefits to customers, the Company will operate under the Plan in a way that parallels the current practices embedded in its previous asset management contracts with its outsource suppliers (*e.g.*, Merrill Lynch, ConocoPhillips).
- D. The starting point for the measurement of the optimization benefits will be based on a least cost dispatch order of the available resources in the supply portfolio coupled with a one-seventh ratable storage refill plan. The Company will receive a sharing of the benefits under this incentive plan to the extent it reduces costs below the level obtainable through purchasing under the least cost purchase dispatch order and ratable storage fill plan.
- E. This Plan will not be affected by or interact with the Gas Purchase Incentive Plan (“GPIP”) in any way. Because GPIP utilizes the purchase of future contracts for hedging, the GPIP does not affect the direct purchasing of supplies or the use of storage in any way, making the two plans entirely independent. The Company will operate under the Plan in a way that parallels the current practice; therefore the effectiveness of the GPIP will not be affected in any way.

III. Revenue Sharing

A. Rhode Island Customer Guarantee

The Company will guarantee an annual gas cost optimization benefit to Rhode Island customers of \$1,000,000 regardless of the total net proceeds realized from optimizing the portfolio during twelve-month period commencing each April 1. Rhode Island customers will receive 1/12th of the \$1,000,000 (83,333.33/month) guarantee in each month. The remaining revenue sharing benefit to the customers will be applied to the GCR following the calculation period.

B. Sharing of Net Proceeds above the first \$1,000,000

Rhode Island customers will receive 80% of all net proceeds above the first \$1,000,000 and the Company will receive 20% of the net proceeds above the first \$1,000,000.

C. Calculation of Optimization Benefits

The optimization benefit will be calculated annually for the optimization activity executed during the year. The optimization benefit for revenue sharing will be calculated as the positive value of; the revenue from sales to the Rhode Island customers at the citygate and storage facilities, plus the revenue from sales to third parties, less the costs to procure all supplies as well as all variable costs associated with the purchase, delivery and storage.

IV. Description of the Least Cost Dispatch Order

- A. The least cost dispatch order, by which natural gas will be priced for Rhode Island customers for baseload and daily nominations will be based on published index prices, as it is in the current contract. An index price is a published price for gas supply at a particular location, in this case, the point of receipt for the Company's pipeline capacity where it purchases supply to transport on its pipeline transportation capacity. Each year, the Company will analyze the historic reference index price for each receipt point and each asset path's delivered price to the citygate. Based on these historical index prices and the delivered cost of each path, the Company will establish an order from the least cost to the highest cost path. To establish a least cost dispatch, the Company will match the index price order with the available assets for each month. This process will be performed more frequently if changes occur to the portfolio (*e.g.*, new

pipeline services are added to the portfolio) or changes occur in the wholesale market that would impact the least cost dispatch. The Company will notify the Division of the least cost dispatch order prior to the start of the year and inform it of any changes during the year.

- B. An index price formula will not be used in non-standard transactions. Examples of non-standard transactions are intraday purchases, non-ratable weekend purchases, fixed price, fixed basis transactions at a location that does not have a published index, or other Additional Company Assets described below in section VI. For non-standard transactions, the actual purchase price, plus variable costs to deliver, will be charged to the Rhode Island customers.
- C. The Index Pricing formula uses Platts “Inside FERC’s Gas Market Report, Prices of Spot Gas Delivered to Pipelines”, for baseload gas purchases for any month (FOM). The Index Pricing formula uses Platts “Gas Daily, Daily price survey”, Midpoint prices for gas purchased for next day or ratable deliveries over the weekend (Gas Daily).

VI. Baseload and Daily Nominations

- A. Baseload Nominations - Each month, at least six business days prior to the start of the month of flow, the Company will nominate a separate baseload volume for deliveries at the Tennessee Gas Pipeline citygates and the Algonquin Gas Transmission citygates as under the current practice.. This volume will be priced to the Rhode Island customers based on the least cost dispatch as described above in Section IV.
- B. Daily Nominations – Each day, prior to 8:30AM EST, the Company will nominate a separate, incremental daily volume for deliveries at the Tennessee Gas Pipeline (TGP) citygates and the Algonquin Gas Transmission (AGT) citygates as under the current practice. To fill this incremental daily need, the Company will dispatch supply from any or any combination of the available sources below:
 - a. Transportation capacity – The Company nominates volumes from the remaining transportation capacity at each pipeline citygate. This volume is priced to the Rhode Island customers based on the next available asset path under a least cost dispatch as described in Section IV.

-
- b. Storage – The Company may nominate supply from each storage facility as is the current practice subject to contractual limitations. Intraday injections or withdrawals will be subjected to the remaining capabilities of each storage facility and may be affected by certain pipeline and/or storage facility restrictions;
 - c. Citygate purchases – At times, the Company may nominate volumes to be purchased at its citygates. This volume will be priced to the Rhode Island customers based on the actual purchase price and will be a direct pass through; and
 - d. Additional Company Assets – The Company may nominate volumes from any other available asset at its disposal. These include, but are not limited to peaking supplies or any liquid/vapor such as the FLS and FCS contracts with Distrigas. This volume will be priced to the Rhode Island customers based on the actual contract price or inventory cost plus variable delivery costs.

C. Storage Injections

- a. During the months of April through and including October, Storage injection quantities will be calculated as 95% of the total storage Maximum Storage Quantity (MSQ), less the ending inventory on March 31. As is the practice today, this quantity will be deemed to be injected ratably over the seven month period. Any Rhode Island customer withdrawals in April will be deemed to be injected ratably over the next six months, May through October period; and
- b. The price of the April through October injections is set in accordance with the Index Pricing formula using the FOM index pricing for each of the seven injection months.

VII. The Company as Gas Portfolio Manager

A. Optimizing the Gas Portfolio

As asset manager, the Company will dedicate the resources to recognize and realize arbitrage and optimization opportunities by structuring a combination of transactions using the portfolio of assets and its flexibility to take advantage of opportunities that arise in the marketplace to reduce gas costs. Optimization of the assets will be performed as a secondary

process after the Company has met the load requirements of the Rhode Island customers through the least cost dispatch of all required assets.

- B. Typical optimization strategies are:
- a. Transportation capacity – the Company will lock-in the price difference between two locations with the use of temporarily idle transportation capacity;
 - b. Citygate exchanges – the Company will use its citygate receipt flexibility to capture price differences between the two delivering upstream pipelines , Tennessee Gas Pipeline and Algonquin Gas Transmission;
 - c. Storage – The Company will use the temporarily idle capacity, injections or withdrawal rights to capture the price difference between two time periods; and
 - d. Purchase Replacement - The Company will look to resource purchase obligations to effectuate a lower delivered price.

VIII. Reporting Requirements

- A. Quarterly reports – The Company will provide quarterly reports showing the realized and unrealized margins associated with the portfolio optimization value. Reports will be provided on the first business day after the 25th of the month following the end of each fiscal quarter.
- B. Annual Report – The Company will provide an annual report showing the total realized and unrealized margins generated through portfolio optimization in addition to the distribution of the sharing between the Rhode Island customers and National Grid. This report will be provided on the first business day following June 1 of each year.

Illustration - NGPMP Sharing		
In millions		
<u>Portfolio Value</u>	<u>Rhode Island Customers</u>	<u>National Grid</u>
\$2	\$1.8	\$0.2
\$4	\$3.4	\$0.6
\$6	\$5.0	\$1.0
\$8	\$6.6	\$1.4
\$10	\$8.2	\$1.8
\$12	\$9.8	\$2.2

DIRECT TESTIMONY

OF

ELIZABETH DANEHY ARANGIO

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II.	Overview of the Company's Gas Supply Planning Process.	3

1 **I. INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Elizabeth Danehy Arangio. My business address is 201 Jones Road,
4 Waltham, Massachusetts 02451.

5 **Q. WHAT IS YOUR POSITION WITH NATIONAL GRID?**

6 A. I am the Director of Gas Supply Planning with responsibility for the gas-resource portfolio
7 held by National Grid in Rhode Island. I am also responsible for gas supply planning for
8 the National Grid resource portfolios in Massachusetts, New York, and New Hampshire.
9 For purposes of this testimony, references to “National Grid” or the “Company” relate
10 solely to The Narragansett Electric Company which is doing business in Rhode Island as
11 National Grid.

12 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND YOUR PROFESSIONAL**
13 **EXPERIENCE.**

14 A. I graduated from the University of Massachusetts in 1991 with a Bachelor of Business
15 Administration. In 1995, I graduated from Bentley College with a Master of Business
16 Administration. From 1991 to 1994, I worked as a Gas Accounting Analyst in the
17 Marketing Operations Department at Algonquin Gas Transmission Company. In 1994, I
18 joined Boston Gas Company as a Gas Supply Analyst. In 1997, I was promoted to Group
19 Leader Transportation Services, with responsibility for managing all activities associated
20 with the customer-choice program. In 1998, I was promoted to Director of Gas
21 Acquisition and Transportation Services with responsibility for the administration of the

1 Company's gas-resource portfolio and customer-choice program in Massachusetts and, as
2 of 2000, the resource portfolio of EnergyNorth Natural Gas, Inc in New Hampshire. In
3 February 2004, I assumed the additional responsibility of gas supply planning for the
4 former KeySpan Corporation New York and Long Island resource portfolios. Following
5 the acquisition of KeySpan Corporation by National Grid, plc, I was named to my current
6 position with the added responsibility for the National Grid gas resource portfolios in
7 upstate New York and in Rhode Island.

8 **Q. ARE YOU A MEMBER OF ANY PROFESSIONAL ORGANIZATIONS?**

9 A. I am a member of the Northeast Gas Association and the New England-Canada Business
10 Council.

11 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY PROCEEDINGS?**

12 A. Yes. I have recently testified before the Rhode Island Public Utilities Commission in
13 support of National Grid's gas supply plan. In the past, I have testified numerous times
14 before the Massachusetts Department of Public Utilities and the New Hampshire Public
15 Utilities Commission.

16 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

17 A. The purpose of my testimony is to describe the role of the Gas Supply Planning Group in
18 the procurement of natural gas supplies for customers in Rhode Island, today under the
19 asset management plan with Merrill Lynch ("Merrill") and into the future under the
20 proposed Natural Gas Portfolio Management Plan ("NGPMP"). I will describe the gas
21 supply

1 planning process and the supply portfolio that is available to serve Rhode Island
2 customers.

3 **Q. ARE THERE ANY EXHIBITS INCLUDED WITH YOUR TESTIMONY?**

4 A. No.

5 **II. OVERVIEW OF THE COMPANY'S GAS SUPPLY PLANNING PROCESS.**

6 **Q. PLEASE DESCRIBE THE COMPANY'S GAS SUPPLY PLANNING PROCESS FOR RHODE ISLAND.**

7 A. The fundamental goal of the Company's gas supply planning process is to ensure that there
8 are adequate gas supplies to reliably meet the needs of customers over the planning period,
9 even under design winter conditions. To meet this objective, the Company initially
10 determines its load requirement using three basic steps (a) establishment of planning
11 criteria (e.g., design weather conditions, local pressure requirements); (b) preparation of a
12 demand forecast under normal weather conditions for firm-service customers including
13 those transportation customers; and (c) conversion of the normal weather load requirement
14 to a design weather load requirement. In order to meet the load requirements under design
15 weather conditions, the Company maintains a resource portfolio consisting of pipeline
16 transportation, underground storage and peaking resources.

17 At this time, Rhode Island is directly served by two interstate pipelines—Tennessee Gas
18 Pipeline ("Tennessee") and Algonquin Gas Transmission Company ("Algonquin"). There
19 are currently ten Algonquin citygates and four Tennessee citygates. The Company has
20 capacity contracts that allow it to move gas supplies along a variety of transportation paths

1 to the Company's citygates.

2 In addition to pipeline capacity, the Company relies on underground storage capacity to
3 meet fluctuations in customer requirements throughout the winter season. Similarly,
4 peaking resources are used to meet winter requirements not met by pipeline and
5 underground storage resources. Peaking resources are comprised of both third-party
6 delivered supplies as well as the Company's on-system LNG facilities. In addition to
7 serving as a supply source, the on-system LNG facilities are a critical resource used to
8 meet hourly load fluctuations and to balance pressures across portions of the distribution
9 system during periods of high demand.

10 **Q. WHAT ROLE DOES THE GAS SUPPLY PLANNING GROUP PLAY IN DETERMINING THE**
11 **BASELOAD AND DAILY SWING VOLUMES OF GAS SUPPLIES FOR USE IN RHODE ISLAND?**

12 A. The Gas Supply group uses the SENDOUT model to perform a dispatch optimization of
13 the entire Rhode Island portfolio of gas supply, pipeline transportation, underground
14 storage and peaking supplies. The model uses commodity price, pipeline contract and
15 storage information to determine the dispatch of supplies to minimize the cost of supply
16 over the year.

17 Each month, by no later than 10 a.m. Eastern Time five (5) business days prior to the final
18 NYMEX close date for the month of gas flow, the Gas Supply Planning group determines
19 the baseload volume requirements for delivery to the Tennessee citygates and the
20 Algonquin citygates. This volume is priced to the Rhode Island customers based on the
21 least cost dispatch as set forth in the Index Pricing formula currently used under the Asset

1 Management Agreement with Merrill. This pricing arrangement would remain the same
2 under the proposed NGPMP.

3 Each day, prior to 8:30 AM EST, the Gas Supply Planning group nominates a separate,
4 incremental daily volume for delivery to the Tennessee citygates and the Algonquin
5 citygates if needed. To fill this incremental daily need, the Company elects from one or
6 any combination of the following available options:

7 (1) Transportation—the Company nominates volumes from the remaining
8 transportation capacity at each pipeline citygate;

9 (2) Storage—the Company may nominate volumes from each storage facility subject
10 to contractual limitations. Intraday injections or withdrawals are subject to the remaining
11 capabilities of each storage facility and may be affected by certain pipeline and /or storage
12 facility restrictions;

13 (3) Citygate Purchases—at times, the Company may nominate volumes from any other
14 available asset at its disposal; and

15 (4) Additional Company Assets—these include peaking supplies or any liquid/vapor
16 such as the FLS and FCS contracts with Distrigas.

17 In the winter season, every dispatch decision made takes into account design-forward
18 planning. Simply put, this means that from each day forward, the Company assumes it will
19 experience design weather. Thus, on certain days it may make sense to make a citygate

1 purchase in lieu of dispatching LNG so that LNG is preserved for use later on in the winter
2 season.

3 **Q. WHAT FURTHER ROLE DOES THE GAS SUPPLY PLANNING GROUP PLAY IN ENSURING**
4 **RELIABILITY OF THE PORTFOLIO?**

5 **A.** The Gas Supply Planning group is responsible for ensuring that all contractual terms and
6 conditions are adhered to. For example, Gas Supply Planning monitors storage inventory
7 levels, during both the injection season as well as the withdrawal season to ensure
8 compliance with each storage provider's tariff. Gas Supply Planning also manages the
9 pipeline balancing activity on a daily basis in order to comply with the respective
10 operational balancing provisions on the Tennessee and Algonquin pipelines. The role of
11 Gas Supply Planning will remain the same under the proposed NGPMP.

12 **Q. ONCE THE COMPANY HAS DETERMINED THE LEAST COST DISPATCH ORDER OF THE**
13 **AVAILABLE RESOURCES IN THE SUPPLY PORTFOLIO, WHAT IS THE NEXT STEP IN THE**
14 **PROCESS?**

15 **A** Under the current gas asset management arrangement, once the Company has provided its
16 daily requirements to the asset manager, the asset manager then attempts to realize
17 optimization opportunities by structuring a combination of transactions using the portfolio
18 assets and its flexibility to take advantage of marketplace opportunities to reduce gas costs.

19 Under the proposed NGPMP, once the Company has met the load requirements of the
20 Rhode Island customers through the least cost dispatch of all required assets, the
21 Company's Energy Transactions Group will perform the role of asset manager.

1 **Q. PLEASE DESCRIBE THE BENEFIT TO RHODE ISLAND CUSTOMERS OF HAVING THE**
2 **COMPANY TAKE A MORE ACTIVE ROLE IN THE MANAGEMENT OF THE PORTFOLIO?**

3
4 A. By taking a more active role in the management of the portfolio, the Company greatly
5 enhances the overall reliability of the gas supply function. In the past, the Company has
6 experienced great difficulty with respect to maintaining experienced staff once the
7 portfolio has been fully-outsourced. In such event, the Company had lost the capability to
8 step in and effectively manage an outsourced portfolio in the event that the asset manager
9 can no longer manage the assets. In these circumstances, the Company has been fortunate
10 to have found another full-outsource asset manager in a time of desperation. In
11 acknowledgement of this vulnerability, the Company began the process several years ago
12 of building a capable staff and taking an active role in managing its New York,
13 Massachusetts, and New Hampshire portfolios. Now that the Company has developed the
14 full capability to manage its portfolios, National Grid is prepared to develop like capability
15 through the NGPMP proposal.

16
17 Furthermore, through active management of the portfolio, the Company is able to mitigate
18 the credit risk that is inherent with a fully-outsourced portfolio manager. In particular,
19 when the Company maintains control of the underground storage inventory, the credit and
20 operational risks associated with a third-party maintaining control of storage inventory is
21 eliminated.

22 **Q. DOES THIS CONCLUDE YOUR DIRECT PREFILED TESTIMONY IN THIS PROCEEDING?**

23 A. Yes, it does.

DIRECT TESTIMONY

OF

GARY L. BELAND

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1 **I. INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Gary L. Beland. My business address is 280 Melrose Street, Providence,
4 Rhode Island 02907. I am employed by The Narragansett Electric Company, doing
5 business as National Grid in Rhode Island (“National Grid” or “Company”).

6 **Q. WHAT IS YOUR POSITION AND RESPONSIBILITIES?**

7 A. I am Manager in the Pricing and Regulatory Department for National Grid. My
8 responsibilities include state regulatory matters related to gas supply.

9 **Q. WHAT IS YOUR BACKGROUND AND EXPERIENCE?**

10 A. I began my career in the natural gas industry in June 1977 as an analyst in the Rates and
11 Regulatory Affairs Department of Michigan Consolidated Gas (“MichCon”) after
12 receiving a Masters of Business Administration from the State University of New York
13 in Albany. At MichCon, I worked on a variety of projects and studies including
14 pipeline rate filings, state rate cases, demand modeling, gas-supply cost simulations,
15 conservation planning and strategic analyses.

16 In 1983, I was hired by Niagara Mohawk as a Corporate Planner. In that position, I was
17 responsible for strategic analysis and a variety of projects including integrated resource
18 planning, pipeline regulatory monitoring and intervention, both end-use based and

1 econometric electric and gas-demand forecasting, fuel-cost forecasting and modeling
2 and gas market unbundling. In 1987, I joined the newly formed gas business unit as
3 Manager of Gas Supply Planning. While I was at Niagara Mohawk, I was involved in
4 the Forecasting and Planning Sub-Committee of the New York Power Pool and the
5 Planning Committee of the New York Gas Group, serving as Chairman at the time I left
6 to join the Providence Gas Company (“ProvGas”) in 1994.

7 I joined ProvGas in 1994 as the Manager of Gas Supply. In 1997, I became Assistant
8 Vice President. After the merger with Southern Union Company, I was named Director
9 of Gas Supply for the New England Division. From 1997 to 1999 I served on the
10 Executive Committee of the Gas Industries Standards Board.

11 I have testified in several dockets before the Federal Energy Regulatory Commission.
12 I have also testified before the New York Public Service Commission on gas and
13 electric market forecasts and a gas-cost incentive mechanism. I have testified in
14 Massachusetts on gas supply and supply planning matters. In Rhode Island, I have
15 testified before this Commission on numerous gas supply issues.

16 **II. PURPOSE OF TESTIMONY**

17 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

18 A. My testimony provides an explanation of the relationship between the Gas Purchase
19 Incentive Plan (“GPIP”) and the proposed Natural Gas Portfolio Management Plan

1 (“NGPMP”). It also addresses some of the costs that will be incurred as the Company
2 changes from outsourcing to insourcing. Finally, my testimony discusses the least cost
3 methodology embedded in past asset management contracts.

4 **Q. ARE YOU SPONSORING EXHIBITS TO YOUR TESTIMONY?**

5 A. No.

6 **III. DISCUSSION**

7 **Q. HOW IS GAS PURCHASING CONDUCTED UNDER THE GPIP?**

8 A. Under the GPIP gas prices are systematically locked in over a 24-month period with the
9 objective of stabilizing prices and protecting customers from the impacts of large price
10 swings. Prior to July 1, 2007, the Company implemented the locking of the NYMEX
11 (commodity) portion of gas prices by systematically purchasing physical gas supplies at
12 prevailing future prices for delivery in future months. Beginning July 1, 2007, the
13 Company implemented the GPIP hedging through the purchasing of gas futures
14 contracts, separating the physical delivery of the gas from the price hedging function.

15 As of April 1, 2009, when this program is scheduled to begin, all hedges in place for the
16 benefit of Rhode Island customers will be settled financially rather than through the
17 actual purchase of supply. Most of the hedges in place will be futures contracts and
18 each month, three business days prior to the start of the month when the contract for the
19 upcoming month is about to expire, all the financial futures contracts purchased for that
20 particular month over the prior 24 months will be sold. If the overall revenue from the

1 sale of those futures contracts is greater than their cost, gas costs will be credited for the
2 difference. Conversely, if revenues are less, gas costs will be debited. In addition to the
3 futures contracts used to hedge future gas costs for customers, the Company also has a
4 small number of deals which were converted from a fixed priced physical contract to a
5 financial instrument known as a swap. Like the futures contracts, the swaps are settled
6 financially and the net difference is either credited or debited to gas costs.

7 **Q. PLEASE DESCRIBE THE ASSET MANAGEMENT ARRANGMENT WITH MERRIL LYNCH**
8 **THAT IS CURRENTLY IN EFFECT.**

9 A. The Merrill Lynch asset management contract is very similar to the previous
10 ConocoPhillips asset management arrangement which it replaced beginning April 1,
11 2008. The Company releases or assigns Merrill Lynch a majority of the gas supply
12 portfolio and in return Merrill Lynch provides asset management services and a fixed
13 monthly asset management credit to the cost of gas Merrill Lynch is selling to the
14 Company. The Merrill Lynch asset management contract differs from the previous
15 ConocoPhillips arrangement in the timing of the payment for storage inventory. Under
16 the ConocoPhillips deal National Grid paid ConocoPhillips as gas was injected into
17 storage during the April through October period. In the Merrill Lynch deal National
18 Grid does not pay for the storage inventory until gas is withdrawn from storage and
19 delivered to the Rhode Island customers. This change was made to reduce the credit
20 exposure inherent in the prepayment of inventory in the ConocoPhillips arrangement.
21 The Merrill Lynch Asset Management arrangement is due to expire on April 1, 2009.

1 **Q. HOW, IF AT ALL, WILL REPLACING THE ASSET MANAGEMENT ARRANGEMENT WITH**
2 **THE NGPMP AFFECT THE OPERATION OF THE GAS PURCHASE INCENTIVE PLAN**
3 **(“GPIP”)?**

4 **A.** Implementation of the NGPMP will have no effect on the GPIP. As is described above,
5 the GPIP is a hedging plan that operates to stabilize gas costs through the use of
6 financial instruments that are separate from the Company’s physical purchase of supply
7 or its management of storage. The net results have the same impact on gas costs that
8 the previous methodology of fixing the price of gas in the physical purchases did prior
9 to June 2007. The NGPMP, as an asset management plan, is designed to optimize the
10 total gas supply portfolio in order to minimize the cost to customers. Thus, the two
11 plans are independent and it is irrelevant whether the assets are optimized by the
12 Company or an outside asset manager.

13 **Q. WILL THE INSOURCING OF THE ASSET MANAGEMENT FUNCTION INCREASE COSTS TO**
14 **CUSTOMERS?**

15 **A.** No. The Company is not proposing to increase costs to customers as a result of the
16 NGPMP. To some extent, the Company will experience costs that it does not incur
17 today because those costs are being borne by the current asset manager. While the
18 Company will be dedicating personnel and resources necessary to execute the supply
19 management transactions, the Company is not seeking the recovery of any incremental
20 staffing costs at this time.

1 There will also be other incidental costs incurred to conduct the supply and asset
2 management process. For example, the Intercontinental Exchange (ICE) is a trading
3 platform the Company will use to execute some of its trades. Each completed
4 transaction on ICE pays a small fee (\$0.00025 per dekatherm) based on the volume
5 traded. There is a minimum monthly fee of \$500 per trading ID that is offset by the
6 actual trading commissions. Based on our tariff and fact that the fees will be incurred
7 directly as a result of gas purchase activity, the Company would expect to recover the
8 fees as a gas cost.

9 Similarly, the Company also uses a subsidiary of ICE to ensure that deals are verified
10 by an independent party. This is an important part of the Company's financial controls
11 and Sarbanes-Oxley compliance strategy. Charges for verification of a physical trade
12 are \$3.00.

13 **Q. HOW HAS THE COMPANY IMPLEMENTED LEAST COST PURCHASING IN PAST ASSET**
14 **MANAGEMENT CONTRACTS AND HOW DOES THAT RELATE TO THE INSOURCING?**

15 **A.** In the past, when the Company put asset management arrangements out for bid, it
16 included in the bid package a dispatch order which, based on historical data, was set up
17 so that the first supply purchased, whether daily or monthly, was that which was
18 expected to have the lowest delivered cost.

19 In addition, unlike many outsourcing arrangements, the Company retained the right to
20 dispatch storage withdrawals at its own discretion rather than on any fixed schedule,

1 leaving it free to make decisions each day on whether it was more economical to pull
2 storage or to purchase supply and manage storage to maximize its availability during
3 cold weather.

4 Storage refill was set up to occur on a ratable basis, one-seventh per injection month.
5 This approach offers the advantage of spreading the cost over the greatest number of
6 months, maximizing the price stability impact of the injections. At the same time, the
7 customers benefited from the optimization opportunity created by following a fixed
8 schedule which the asset manager could then optimize and, through its bid, pass on
9 additional savings to customers.

10 Each of these approaches has worked well in the past in optimizing and stabilizing gas
11 costs to customers. Through this plan, the Company will continue to provide these
12 benefits to customers.

13 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

14 **A.** Yes, it does.

**Legal Notice of National Grid Filing for
Natural Gas Portfolio Management Plan**

Pursuant to the Rhode Island General Laws, Sections 39-3-10 and 39-3-11, National Grid filed with the Rhode Island Public Utilities Commission (PUC) on February 23, 2009 its request for approval of a Natural Gas Portfolio Management Plan (“NGPMP”) to become effective on or after April 1, 2009, RIPUC Docket No. _____.

The NGPMP is designed to encourage the Company to minimize gas costs to customers by allowing the Company to share in savings it obtains by optimizing the use of the Rhode Island gas supply portfolio resources. As part of this program, the Company will discontinue outsourcing the management of the portfolio and take direct control of the gas portfolio assets.

Under the NGPMP revenue sharing provisions, Rhode Island customers will be guaranteed an annual gas cost optimization benefit of \$1 million during the twelve-month period commencing each April 1 or as directed by the Commission. In addition, Rhode Island customers will receive 80% of all net proceeds above the first \$1 million, with the Company receiving 20%.

A copy of the filing is on file for examination at National Grid, 280 Melrose Street, Providence, Rhode Island and at the office of the Public Utilities Commission, 89 Jefferson Blvd., Warwick, Rhode Island. This notice is given pursuant to the PUC’s Rules of Practice and Procedure as adopted on May 1, 1998. The Commission is accessible to the handicapped. Individuals requesting interpreter services for the hearing impaired must contact the Clerk of the Commission seventy-two hours in advance of the hearing.

National Grid