nationalgrid

Jennifer Brooks Hutchinson
Senior Counsel

March 3, 2016

VIA HAND DELIVERY AND ELECTRONIC MAIL

Luly E. Massaro, Commission Clerk
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02888

RE: Natural Gas Portfolio Management Plan (NGPMP)
<u>Modification Request</u>

Dear Ms. Massaro:

Enclosed for filing is National Grid's[1] request for approval for changes to its Natural Gas Portfolio Management Plan (NGPMP) incentive sharing mechanism, effective April 1, 2016. This filing consists of the pre-filed testimony and attachments of Stephen A. McCauley. In his testimony and attachments, Mr. McCauley explains the Company's proposal to modify the NGPMP incentive sharing mechanism.

The Company is proposing to (1) eliminate the guaranteed minimum benefit to customers, and increase the NGPMP minimum sharing threshold for the Company from $1 million to $2 million; and (2) change the margin sharing split once actual margins generated reach the $2 million threshold, such that the Company will earn a lesser incentive in years in which margins are high. Under the new sharing mechanism, for margins from $2 million to $5 million, the customers will receive 80% of the excess margins, and the Company will receive 20% of the excess margins. For margins from $5 million to $10 million, the customers will receive 90%, and the Company will receive 10%, and for all margins exceeding $10 million, the customers will receive 94% of the excess margins, and the Company will receive 6% of the excess margins.

The Company has discussed the proposed changes to the NGPMP with the Rhode Island Division of Public Utilities and Carriers, and they concur with these changes.

Thank you for your attention to this matter. If you have any questions, please contact Stephen McCauley at (516) 545-5403 or me at (401) 784-7288.

Very truly yours,

Jennifer Brooks Hutchinson

Enclosures

cc: Stephen Scialabba, Division
Bruce Oliver, Division
Leo Wold, Esq.

[1] The Narragansett Electric Company d/b/a National Grid (National Grid or the Company).

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DIRECT TESTIMONY

OF

STEPHEN A. MC CAULEY

March 3, 2016

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I. Introduction

Q. Please state your name and business address.

A. My name is Stephen A. Mc Cauley. My business address is 100 E. Old Country Road, Hicksville, NY 11801.

Q. What is your position and responsibilities?

A. I am Director of Origination and Price Volatility Management in the Energy Procurement organization of National Grid USA Service Company, Inc. (National Grid). As Director, I am responsible for all financial hedging activity for the National Grid regulated natural gas and electric utilities, including The Narragansett Electric Company (Company). I am also responsible for structuring and optimizing the natural gas assets to help return the most value to the regulated entities.

Q. Please describe your educational background.

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

Q. Please describe your professional experience.

A. I joined National Grid in 1992 as an engineer for the gas peak-shaving plants and the gas-regulator and telemetering stations. In 1996, I joined the gas supply group as a trader responsible for purchasing the natural gas supply requirements for both the firm gas customers and the Long Island Lighting Company generation facilities. In 1999, my responsibilities were changed to managing the emissions-allowance portfolio and the financial-hedging activities of the regulated utilities. In 2002, I was promoted to my current position as Director.

Q. Have you previously testified before the Rhode Island Public Utilities Commission (PUC)?

A. Yes, I have testified before the PUC on several occasions involving gas costs, portfolio management under the Natural Gas Portfolio Management Plan (NGPMP) and volatility management of gas prices under its Gas Procurement Incentive Plan (GPIP).

Q. Are you sponsoring any Attachments?

A. Yes. I am sponsoring the following attachments:

Attachment SAM-1 Total Optimization Revenue

Attachment SAM-2 Customer’s NGPMP Benefit

Attachment SAM-3 Company’s NGPMP Incentive

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe the Company’s proposed changes to the Natural Gas Portfolio Management Plan sharing mechanism.

II. Company's Proposal to Natural Gas Portfolio Management Plan (NGPMP)

Q. Please briefly describe the NGPMP.

A. In Docket No. 4038, the PUC approved the NGPMP which implemented changes to the management of the Company's gas portfolio. These changes were designed to provide various financial, regulatory, and risk management benefits over the previous asset management arrangements. The Company changed the management of the gas portfolio from an external third-party asset-management agreement to a portfolio managed primarily by the Company. The Company uses its transportation contracts, underground storage contracts, peaking supplies, and supply contracts first to purchase gas supplies to economically and reliably serve sales customers, and then to make additional purchases and sales that generate revenue by extracting value from any assets that are not required to serve customers on any day. The mix of supply, transportation, and storage contracts creates flexibility and opportunities for optimization to create value for the Company's customers. This potential optimization value is subject to market variables: the fluctuation of gas pricing, the value of temporarily unused assets, the existence of excess transportation and storage capacity, and the opportunities to optimize delivered supplies as storage fill opportunities arise.

Q. How long has the Company been operating under the NGPMP?

A. The NGPMP was first approved in 2009, and the Company started to internally manage the portfolio in April of that year. After operating under the NGPMP for three complete years, the PUC approved the NGPMP again in 2012 without any changes, except that the Company would no longer receive a share on fees collected from third-party Asset Management Agreements. The PUC approved the NGPMP with no termination date, but encouraged the Division and the Company to evaluate the NGPMP each year, and make recommended changes as market conditions warranted.

Q. What is the current margin sharing?

A. Under the current margin sharing mechanism, the Company guarantees the customers a minimum benefit of $1 million dollars in each fiscal year beginning April 1 and ending March 31. If the portfolio fails to generate more than $1 million, then the Company is responsible to make up the difference between the actual margins generated in the incentive year and the $1 million guarantee. In any year in which the margins exceed $1 million, then the customers will receive 80% of the excess, and the Company will receive 20% of the excess.

Q. What has been the performance of the NGPMP?

A. Attachment SAM-1 Total Optimization Revenue shows the revenue generated each year from 2010 through 2015.

Q. What are the changes that the Company is proposing to the NGPMP margin sharing in this filing?

A. The Company is proposing to eliminate the minimum guarantee and to increase the NGPMP minimum sharing threshold from $1 million to $2 million. The first $2 million is a threshold for when the Company will begin to share in the benefits; however, if margins (i.e. difference between revenue and expenses) are less than $2 million, the Company will no longer make up the difference between the actual margins generated and the $2 million threshold. Customers will receive 100% of the first $2 million of margins.

The Company is also proposing to change the margin sharing split once actual margins generated reach the $2 million threshold. For margins from $2 million to $5 million, the customers will receive 80% of the excess margins, and the Company will receive 20% of the excess margins. For margins from $5 million to $10 million, the customers will receive 90% and the Company will receive 10%, and for all margins exceeding $10 million, the customers will receive 94% of the excess margins and the Company will receive 6% of the excess margins.

Q. How will the new sharing mechanism impact the customers' benefit and the Company's incentive?

A. Attachment SAM-2 NGPMP Customer Benefit shows the change from the current sharing mechanism to the proposed sharing mechanism for the customers. Attachment SAM-3 NGPMP Company Incentive shows the change from the current incentive mechanism to the proposed incentive mechanism for the Company. In Attachment SAM-2 the dotted line indicates the total customer benefit compared to the potential total margin generated for the current sharing mechanism. The solid line indicates the total customer benefit compared to the potential total margin generated for the proposed sharing mechanism. For example, if the portfolio generates total margins of $10 million, under the current sharing mechanism, the customer would receive a benefit of $8.2 million, and under the proposed sharing mechanism, the customer total benefit would increase to $8.9 million. Similarly in Attachment SAM-3, the dotted line shows the current incentive for the Company for a range of total margins, and the solid line shows the reduced incentive under the proposed incentive sharing mechanism.

Q. Why is the Company recommending changes to the Plan?

A. When the Company proposed the NGPMP in 2009, margins generated with the portfolio were typically in the $2 million to $4 million per year range with an outlier of $7 million in 2008. The purpose of the NGPMP at that time was to create a structure with an incentive mechanism that would encourage the Company to maximize the savings to the customers, and provide a reasonable incentive for the Company's effort. As noted in the pre-filed direct testimony of Mr. Bruce Oliver, consultant to the Division of Public Utilities and Carriers (Division) in the Company's 2015 Gas Cost Recovery (GCR) Filing, Docket No. 4576, the margins under the NGPMP mechanism exceeded $11.4 million, producing the largest customer benefit (over $9.4 million) from the NGPMP program to date. See Attachment SAM-1. In addition, the Company earned its largest incentive of approximately $2.1 million under the program to date, as shown in Attachment SAM-3.

Neither the Company nor the Division could have anticipated that the margins would have exceeded the historical margins experienced up until 2015. The reason for this increase in margins is, in part, because of the existing gas pipeline capacity restraints in the New England region, which are expected to continue until new interstate pipeline capacity is built. This market variable has afforded the Company opportunities for greater optimization than previously experienced in the program, but also yielded a higher than anticipated incentive to the Company. The program did not intend for such a result when it was approved in 2009. As a result, following the 2015 GCR proceeding, the Company and the Division agreed to re-evaluate the NGPMP margin sharing mechanism to create an incentive structure that would still encourage the Company to maximize savings for the customers, but limit the Company's incentive in years in which margins are high. The Company believes that the NGPMP proposal in this filing balances both objectives.

Q. When will the new incentive sharing mechanism become effective?

A. The Company is proposing that the changes to the NGPMP become effective April 1, 2016 for the NGPMP period April 1, 2016 to March 31, 2017.

Q. Is the Company making any additional modifications to the NGPMP?

A. The Company is not recommending any additional changes to the NGPMP at this time.

Q. Does this conclude your testimony?

A. Yes.

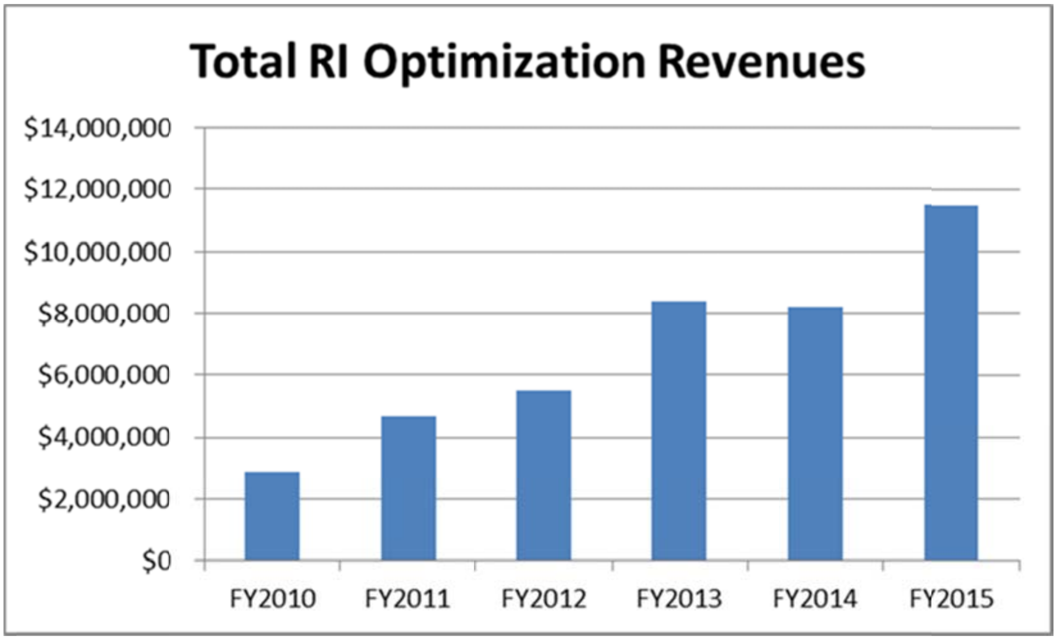
Attachments of Stephen A. Mc Cauley

Attachment SAM-1 Total Optimization Revenue

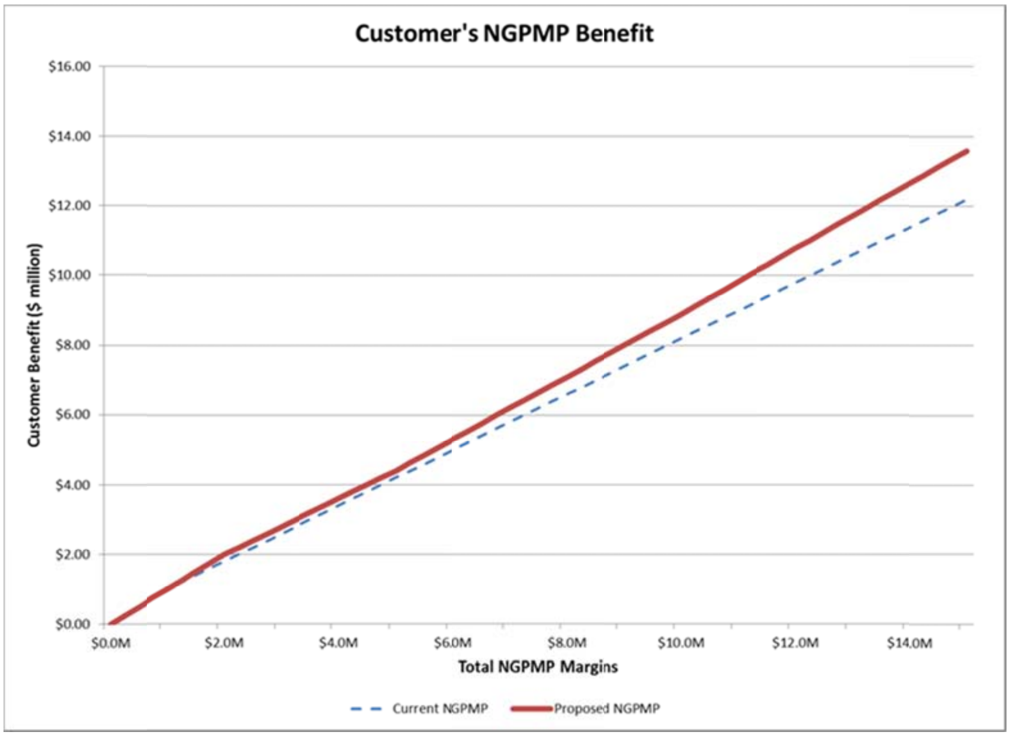
Attachment SAM-2 Customer's NGPMP Benefit

Attachment SAM-3 Company's NGPMP Incentive

Attachment SAM-1
Total Optimization Revenues



Attachment SAM-2
Customer's NGPMP Benefit



Attachment SAM-3
Company's NGPMP Incentive