**MEMORANDUM**

**TO:** Rhode Island Public Utilities Commission

**FROM:** Bruce R. Oliver, Revilo Hill Associates, on behalf of the Division of Public Utilities and Carriers

**DATE:** October 8, 2013

**SUBJECT:** Review of National Grid's 2013 GCR Filing, Docket 4436.

This memorandum reports on the status of the review by Revilo Hill Associates, Inc. of National Grid's 2013 Annual Gas Cost Recovery filing. Due to the limited time between the filing of the Company's testimony and exhibits and the due date for submission of the Division's assessment of the Company's filing, our assessment is not complete as of this time, and the some of the observations offered below must be considered preliminary.

The Company's September 3, 2013 filing comprises two non-confidential volumes (plus an additional volume which contains confidential material), testimony of three witnesses, and supporting schedules totaling 430 pages. We have prepared and submitted three sets of data requests relating to those materials, but to date, time has permitted the Company's response to most of those requests only in the past few days, and we have had less than one week to review and analyze the content of those responses. Furthermore, I note that we have asked in the past that the Division's review of the Company's filing be facilitated by the Company's provision of the electronic spreadsheet files from which filed schedules are generated at the time of the filing of its Direct Testimony. That has not occurred this year. Rather, only in the last couple days have we started to receive such files. We therefore, reiterate that in the context of the tight time schedule for review of National Grid's annual GCR filings, the importance of early receipt of supporting workpapers and electronic spreadsheet files cannot be overstated.

Based on the information and materials reviewed to date, we offer the following observations:

1. Overall the Company's projected costs of gas for recovery during the November 1, 2013 through October 31, 2014 period have declined relative to the costs that the Company projected one year earlier in Docket No. 4346. However, while National Grid's variable gas supply and variable storage costs have declined by 7.2%, the Fixed Gas Supply and Fixed Storage Costs have risen significantly.

    a. The Company's projected total Fixed Gas Supply and Fixed Storage Costs for the 2013-2014 GCR year have increased by 29.8% or $12.1 million prior to consideration of Capacity Release Revenue and NGPMP Revenue Sharing.

b. After consideration of Capacity Release Revenue and NGPMP Revenue Sharing, the fixed costs that National Grid seeks to recover through its GCR charges during the 2013-2014 GCR year still reflect a significant 3.1% increase over the prior year's cost projections.

c. The increase in the Company's Fixed Gas Supply and Fixed Storage Costs is primarily driven by a large swing in the reconciliation balance from $10.7 million for 2012-13 to -$4.2 million for 2013-14 as well as a $2.3 million increase in NGPMP **credits**.

2. Prior to consideration of cost adjustments and reconciliations, the Company's Storage Fixed costs have **decreased by 13.7%** relative to those projected for the Company's prior GCR filing. On the other hand, Supply Fixed costs are projected to increase by $12.1 million or **21.2%.** Thus, National Grid's projected fixed costs for 2013-14 (prior to reconciliations and adjustments) are nearly $10.8 million above the overall Fixed Costs that National Grid projected for the 2012-2013 GCR year.

3. After cost adjustments and reconciliations, the Company's Overall Fixed Costs, as shown in Attachment AEL-1, page 2 of 12, reflect a net increase of $5.1 million where the increase in projected Supply Fixed Costs is more than offset by $13.3 million of credits and negative cost adjustments.

4. Conversely, the Company's total projected 2013-2014 Variable Costs (Supply Fixed and Storage Fixed combined), prior to consideration of cost adjustments and reconciliations, have **fallen 22.7%** in comparison to its 2012-2013 projections. However, the Attachment AEL-1, page 3 of 12, identifies more than **$19.2 million** of upward adjustments (driven by a **$16.1 million under-recovered Variable Cost balance**), and those upward adjustments cause National Grid's overall variable costs (including reconciliations and cost adjustments) to increase by 13.6% over the variable costs claimed by the Company in its forecast of gas costs for the 2012-2013 GCR year.

5. Given the Company's cost inputs and its sales and throughput forecasts for the 2013-2014 GCR year, no problems are found in the mathematical computations used to produce the Company's recommended GCR charges.

6. The Gas Cost Reconciliations presented in Attachment AEL-2 are heavily influenced by the $6.8 million[1] upward revision that National Grid made to commodity costs in May 2013. This is the second time in two years that National

[1] The referenced $6.8 million adjustment was made to its claimed commodity costs of gas to reflect costs of gas sold to third parties that were "inadvertently omitted" from its reported gas costs. As indicated in National Grid's response to Division Data Request 1-1, regarding the Company's May 20, 2013 filing, those adjustments to the Company's pipeline commodity charges (coupled with adjustments made to the Beginning Balance, working capital and associated interest) resulted in a total upward adjustment to the Company's deferred gas costs of **$7.3 million**.

Grid has made significant upward revisions to its deferred gas costs that included adjustments to costs that were the subject of prior gas cost reconciliation filings.

7. The Company's recent Monthly GCR Deferred Balance reports show comparatively large **negative** Sales volumes in certain months for the Extra Large LLF and HLF sales service classifications that need further explanation. For example, in May 2013 the Company reflects a negative sales volume for Extra Large LLF customers of (71,177) Dth. That equates to more than 40% of the total annual sales volume for the entire class and warrants further explanation.

8. A comparison of the forecasted **normal weather** sales and throughput in Attachment AEL-1, page 11 of 12, to witness Leary's testimony to the Company's sales and throughput forecasts in its two preceding annual GCR filings finds:

   a. A greater than 4% overall increase in forecasted annual sales and throughput requirements. After years of very low or negative growth, the Company's projections in this Docket represent one of the largest forecasted year-to-year increases in total sales and throughput volumes over the last couple of decades.

   b. An **unexpectedly large increase** in projected sales to **Residential Non-Heating** customers. Although the Company's number of Residential Non-Heating customers and its sales to those customers have generally been declining over the last couple of decades, National Grid's forecasted Residential Non-Heating Sales represents an **increase of greater than 153,000 Dth or 27%** over the prior year forecast. The increase projected in Design Winter requirements for the Residential Non-Heating class is **greater than 37%**.

   c. Very large percentage increases in projected annual sale & throughput and Design Winter Sales for Large HLF, Extra Large HLF, and Extra Large LLF rate classifications. For the two Extra Large rate classifications the forecasted **increases** in Design Winter volumes are **in excess of 125%**.

9. The Company's tariff requires that a high load factor customer have at least 31% of annual gas use in the months of May through October. With projections of greater growth in winter month sales for the Residential Non-Heating class the percentage of gas use for that class in the months of May through October would fall below 31% and would no longer meet the threshold for GCR rate treatment as a high load factor rate classification. Rate equity considerations suggest that this situation should be closely monitored. Also, the Commission should require National Grid to investigate the factors causing the identified change in Residential Non-Heating usage characteristics.

10. Exhibit AEL-1, page 12 of 12, reflects a Design Day Peak for the winter of 2013-14 of **328,454 Dth**. That is 4.27% above the 315,000 Dth Design Day Peak that was forecasted for January 2014 in the Company's March 8, 2012 Long-Range Plan. It is also more than 9,000 Dth or about 3% above the 319,000 Dth that National Grid has forecasted for its Design Day Peak in **2016**. If this forecast is accepted as reliable, then the Company may need additional peak supply resources sooner than expected. In Docket No. 4346, the Division recommended that National Grid be required to provide a new five-year Gas Supply Plan every three years. This requirement is necessary to avoid situations, such as that encountered prior to the preparation of National Grid's last five-year plan, where the Company had progressed beyond the last year of its most recent planning study and the Commission was left with no basis for evaluating the reasonableness of the Company's overall gas supply portfolio. The changes in the Company's forecasted peak requirements identified herein provide further evidence of the need for more frequent review of the Company's long-range gas supply plans.

11. The testimony of National Grid witness McCauley at page 4 of 9 indicates that the Company has earned a calculated GPIP incentive of $453,345 for the reconciliation period (i.e., the nine months ended March 31, 2013). Although the extensive data and computations underlying that determination are still being reviewed, nothing has been identified to date that raises concerns regarding the accuracy of the Company's computed GPIP incentive amount for the nine-month period ended March 31, 2013.[2]

12. Witness McCauley's filed Direct Testimony at page 9, lines 3-5, requests the Commission's approval of a NGPMP incentive to the Company in the amount of $1,482,571.33 for the twelve-month period ended March 31, 2013.

13. Witness McCauley's Direct Testimony at pages 9-10 discusses that the Company's proposal for extension of the NGPMP for an additional four years (i.e., through March 2018). As part of his presentation regarding the proposed NGPMP extension, McCauley suggests that the Company should be free to utilize any combination of (1) internal asset management, (2) capacity release arrangements, and (3) external asset management through Asset Management Agreements (AMAs) with third parties that the Company deems appropriate. Although the Division generally supports the requested extension of the NGPMP, I cannot concur with witness McCauley's suggestion that the Commission should be indifferent with respect to the manner in which National Grid chooses to manage its natural pipeline and storage gas assets.

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[2] The Division's assessment of this matter would be greatly facilitated by the receipt of the electronic spreadsheet files used to generate the pages of Attachment SAM-2 to witness McCauley's testimony at the time of the filing.,

a. When the NGPMP was initiated, National Grid represented that it could provide asset management services more cost-effectively than third parties that offer similar asset management services. In that context, National Grid represented that, through self-management of the Company's gas assets, it could extract greater net asset management benefits for its RI firm service customers.

b. In the last couple of years National Grid has begun outsourcing portions of its gas asset management activities to third parties arguing that the selected third party asset managers can derive greater net asset management revenue from certain assets than National Grid could achieve through internal management of those assets.[3]

c. Third party gas asset managers typically derive their profits from the portion of the expected net revenue they obtain through their management of gas assets that **they do <u>not</u> pay** to the party contracting for their services (e.g., National Grid).

d. The Division has accepted the Company's use of such third-party asset management arrangements as long as they are limited to a comparatively small portion of the Company's overall portfolio of RI natural gas assets.

e. As the portion of the Company's RI natural gas asset portfolio subject to AMAs with third parties increases, the rationale for paying National Grid the current level of incentive on its entire RI portfolio weakens.

f. National Grid has provided no compelling justification for why any incentives should be paid to the Company on revenue derived from third party asset management arrangements. Such incentive payments essentially constitute a requirement for firm service customer in RI to pay twice for the same asset management activities.

14. A significant number of data request responses have been received in the last couple of business days before the submission of this memo which we have not yet had the opportunity to fully review and analyze. If upon further examination of those materials, additional findings of importance surface, we will attempt to supplement the observations provided herein.

[3] The Commission should note that, to date, National Grid has presented no evidence to demonstrate the magnitude of the benefits it derives from AMA's entered into with third parties that it could not achieve through internal management of the same assets. Nor, has the Company provided any evidence that its solicitation of bids for such third-party asset management arrangements has produced competitive results that exceed the benefits it could derive through internal asset management activities.