Raquel J. Webster
Senior Counsel

March 13, 2015

BY HAND DELIVERY AND ELECTRONIC MAIL

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

RE: Docket 4539 - National Grid's Proposed FY 2016 Electric Infrastructure, Safety, and Reliability Plan

Docket 4540 – National Grid's Proposed FY 2016 Gas Infrastructure, Safety, and Reliability Plan

Joint Pre-filed Direct Testimony of Michael D. Laflamme and William R. Richer

Dear Ms. Massaro:

On behalf of National Grid,[1] I have enclosed ten (10) copies of the joint pre-filed direct testimony of Michael D. Laflamme and William R. Richer in the above-referenced dockets.

Thank you for your attention to this matter. If you have any questions, please contact me at 781-907-2121.

Very truly yours,

Raquel J. Webster

Enclosures

cc: Docket 4539 and 4540 Service Lists
Leo Wold, Esq.
Steve Scialabba, Division
Greg Booth, Division
James Lanni, Division
Don Ledversis, Division

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

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Certificate of Service

I hereby certify that a copy of the cover letter and any materials accompanying this certificate was electronically transmitted to the individuals listed below.

Copies of this filing are being hand delivered to the Rhode Island Public Utilities Commission and the Rhode Island Division of Public Utilities and Carriers.

________________________________ March 13, 2015

Joanne M. Scanlon Date

Docket No. 4539 National Grid's FY 2016 Electric Infrastructure, Safety and Reliability Plan - Service List as of 2/27/15

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Docket No. 4540 - National Grid's FY 2016 Gas Infrastructure, Safety and Reliability (ISR) Plan - Service List 1/8/15

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JOINT PRE-FILED DIRECT TESTIMONY

OF

MICHAEL D. LAFLAMME

AND

WILLIAM R. RICHER

March 13, 2015

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I. INTRODUCTION AND QUALIFICATIONS

Q. Mr. Laflamme, please state your full name and business address.

A. My name is Michael D. Laflamme, and my business address is 40 Sylvan Road, Waltham, Massachusetts 02451.

Q. By whom are you employed and in what capacity?

A. I am Vice President, Regulation and Pricing Officer - New England for National Grid USA Service Company, Inc. (Service Company). Service Company provides administrative, corporate, and management services to direct and indirect subsidiary companies of National Grid USA. My current duties include revenue requirements and pricing activities for all New England electric and gas distribution subsidiaries of National Grid USA, including the gas division of The Narragansett Electric Company, d/b/a National Grid (Narragansett or the Company).

Q. Please provide a brief summary of your educational and professional background.

A. In 1981, I earned a Bachelor of Science degree in Business Administration with an emphasis in Accounting from Bryant University in Smithfield, Rhode Island. From 1981 through April 2000, I was employed by various subsidiary companies of Eastern Utilities Associates (EUA), including EUA Service Corporation (EUASC), which provided accounting, financial, engineering, planning, data processing, and other services to all EUA System companies. I joined EUA's accounting department in 1981 and transferred to the revenue requirements section of EUASC's Rate Department in 1985. I held progressively more responsible positions in revenue requirements prior to transferring to the Treasury Services department of EUASC in 1988. I was promoted to the position of Manager of Treasury Services in 1991. The EUA System was acquired by National Grid USA in early 2000, at which time I joined the National Grid Service Company as Manager of Regulatory Support. In October 2007, I assumed the position of Director of Electric Revenue Requirements, and in June 2008, I was promoted to my current position.

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

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

Q. Mr. Richer, please state your full name and business address.

A. My name is William R. Richer, and my business address is 40 Sylvan Road, Waltham, Massachusetts 02451.

Q. Please state your position.

A. I am the Director of Revenue Requirements - Rhode Island for National Grid USA Service Company, Inc. My current duties include revenue requirements oversight for

National Grid's electric and gas distribution activities in New England, including the gas division of the Company.

Q. Please describe your education and professional experience.

A. In 1985, I earned a Bachelor of Science degree in Accounting from Northeastern University. During my schooling, I interned at the public accounting firm Pannell Kerr Forster in Boston, Massachusetts, as a staff auditor and continued with this firm after my graduation. In February 1986, I joined Price Waterhouse in Providence, Rhode Island, where I worked as a staff auditor and senior auditor. During this time, I earned my certified public accountants license in the State of Rhode Island. In June 1990, I joined National Grid in the Service Company (then known as New England Power Service Company) as a supervisor of Plant Accounting. Since that time I have held various positions within the Service Company including Manager of Financial Reporting, Principal Rate Department Analyst, Manager of General Accounting, Director of Accounting Services, and Assistant Controller.

Q. Have you previously filed testimony or testified before the PUC?

A. Yes. I have testified before the PUC on numerous occasions, including previous Electric and Gas ISR proceedings.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to clarify revisions made to the FY 2016 Electric and Gas ISR Plan revenue requirements and submitted to the PUC March 10, 2015 (March 10 Submission).

III. REVISIONS TO THE ELECTRIC AND GAS ISR PLAN REVENUE REQUIREMENTS

Q. Please summarize the revisions made to the revenue requirements since the December 23, 2014 submission to the PUC for the Company's FY 2016 Electric and Gas ISR Plans.

A. The Company made revisions to the revenue requirements for the Electric and Gas ISRs in regards to two issues, both relating to federal income taxes: (1) the extension of federal bonus depreciation through December 31, 2014, and (2) tax net operating losses (NOL). Calendar year (CY) 2014 bonus depreciation resulted in a decrease to both the Electric and Gas revenue requirements of $0.7 million and $0.3 million, respectively. NOL resulted in an offsetting increase to both the Electric and Gas revenue requirements of $0.8 million and $3.1 million, respectively. Together, the overall result of these revisions was an increase to the Electric FY 2016 revenue requirement of $0.1 million and an increase to the FY 2016 Gas revenue requirement of $2.8 million.

IV. EXPLANATION OF BONUS DEPRECIATION AND NOL ISSUES

Q. Please explain what bonus depreciation is.

A. The US tax code provides incentives to businesses to invest in capital assets by allowing tax depreciation deductions that accelerate these deductions over a period of time that is shorter than the actual useful life of those assets. The Modified Accelerated Cost Recovery System (MACRS) has been the long standing method for calculating federal income tax depreciation deductions for businesses. Bonus depreciation, which allows for additional tax depreciation deductions, was first introduced in the US tax code after the September 11, 2001 terrorist attacks to further stimulate capital investment during a difficult period in the US economy. In 2010, Congress passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the Act), which provided for an extension of bonus depreciation. Specifically, the Act provides for the application of 100 percent bonus depreciation for investment constructed and placed into service after September 8, 2010 through December 31, 2011, and 50 percent bonus depreciation for similar capital investment placed into service after December 31, 2011 through December 2012. The 50 percent bonus depreciation rate was later extended through December 31, 2013, and a law was passed on December 19, 2014 to once again extend 50 percent bonus depreciation tax deductions for capital investment made during 2014. This means that the bonus depreciation rules have allowed the Company to take first-year tax deductions of 50 percent or 100 percent of the cost of eligible capital investment since the passage of the Act. Significant capital related tax deductions for bonus depreciation help to significantly lower the amount of cash the Company pays to the federal government for income taxes. These tax cash benefits also help to significantly reduce the Company's net cash investment in ISR assets, and these benefits are used to benefit customers and reduce the overall ISR revenue requirements in the form of deferred taxes which are reflected as reductions to ISR rate base in the revenue requirements calculations.

Q. Please explain why the Electric and Gas ISR revenue requirement calculations were revised for bonus depreciation.

A. As the Company indicated when it filed the Electric and Gas ISR Plans on December 23, 2014, the Company was unable to incorporate in its revenue requirement calculations the impact of the December 2014 extension of federal bonus tax depreciation rules. Therefore, in its December 23, 2014 filing letters, the Company indicated that it would supplement its filing for any impacts the newly signed federal law would have on the Company's Electric and Gas ISR revenue requirements calculations as soon as the Company had an opportunity to review and understand the implications of the newly enacted law. Therefore, on March 10, the Company resubmitted its revenue requirement calculations to incorporate bonus tax depreciation. As reflected in the revenue requirements exhibits, incorporating this bonus tax depreciation change decreased the Company's total FY 2016 Electric and Gas ISR Plan revenue requirements by $0.7 million and $0.3 million, respectively.

Q. You indicated that the second issue that generated a revision to the Company's revenue requirement calculations involves tax net operating losses, or NOLs. What are NOLs?

A. Tax NOLs are generated when the Company has tax deductions on its income tax returns that exceed its taxable income. This does not mean that the Company is suffering losses in its financial statements; instead, the Company's tax NOLs are the result of the significant tax deductions that have been generated in recent years by the bonus depreciation deductions described above, as well as capital repairs tax deductions. In addition to first-year bonus tax depreciation discussed previously, the US tax code allows the Company to classify certain costs as repairs expense, which the Company takes as an immediate deduction on its income tax return; however, these costs are recorded as plant investment on the Company's books. These significant bonus depreciation and capital repairs tax deductions have exceeded the amount of taxable income reported in tax returns filed for FY 2009 to FY 2014, with the exception FY 2011. NOLs are recorded as non-cash assets on the Company's balance sheet and represent a benefit that the Company and customers will receive when the Company is able to realize actual cash savings when it applies these NOLs against taxable income in the future.

Q. Does National Grid generate NOLs frequently?

A. No, it does not. Prior to FY 2009, National Grid generated NOLs very infrequently. During 2009, the Internal Revenue Service (IRS) issued guidance regarding the capital repairs tax deduction. As a result of this additional guidance, the Company recorded a one-time tax expense for repair and maintenance costs in the FY 2009 federal income tax return filed on December 11, 2009 by National Grid Holdings, Inc. The FY 2009 capital repairs tax deduction was particularly large in the first year in which the deduction was taken because the deduction included capital repairs amounts from FY2005 through FY 2009. Since that time, the Company has taken a capital repairs deduction on all subsequent FY tax returns. This has formed the basis for the capital repairs deduction assumed in the Company's revenue requirement. This tax deduction has the effect of increasing deferred taxes and lowering the revenue requirement that customers have paid under the ISR mechanism.

Q. Why are these tax NOLs causing a revision to the Electric and Gas ISR revenue requirements calculations from the calculations originally filed with the PUC on December 23, 2014?

A. As part of the planned revision to the FY 16 Electric and Gas ISR revenue requirements calculations caused by the December 19 law that extended bonus depreciation, the Company's Tax Department reviewed whether any portion of ISR investment may be eligible for bonus depreciation deductibility. In conducting this review, the Tax Department determined that bonus depreciation deductibility resulting from the December 19 law would be limited to the extent that there was insufficient taxable income to absorb the full bonus depreciation tax deduction. Any bonus depreciation that could not be deducted because of excess tax deductions over taxable income would generate NOLs. This prompted the Company to consider whether NOLs were generated since the inception of the Electric and Gas ISR program in FY 2012, and the Tax Department confirmed that in FY 2012, FY 2013, and FY 2014 NOLs were also generated. As described above, prior to FY 2009, NOLs were generated infrequently, and while we were aware that NOLs were generated by the sizable capital repairs deduction covering FY 2005 through FY 2009 when the Company first included a capital repairs deduction in its FY 2009 tax return, we were unaware that NOLs had been generated after FY 2009.

Q. How do these NOLs impact the revenue requirement calculations, and why should customers pay for this error?

A. Inclusion of NOLs in the revenue requirement calculations reduces the amount of the deferred taxes in the derivation of ISR rate base. As described previously, deferred taxes are an offset, or reduction, to ISR rate base and are intended to represent the amount of cash benefit generated and associated with ISR investment related tax deductions that the Company has reflected in its income tax returns. Since the inception of the Electric and Gas ISR programs in FY 2012, the Company has assumed in its revenue requirement calculations that the Company received the full cash benefit of the significant ISR investment related bonus depreciation and capital repairs tax deductions. However, the actual cash benefits from these deductions have been limited due to the fact that the Company, and the consolidated entity for which a consolidated tax return is prepared, reported a taxable loss. Therefore, all previously filed Electric and Gas ISR revenue requirement calculations since FY 2012 have provided customers with too much of a cash benefit associated with these tax deductions by not reducing ISR related deferred taxes by the amount of ISR investment related NOLs.

Q. Why not spread the increase in the FY 2016 revenue requirement over a period of years, especially for the Gas ISR?

A. As explained earlier, the NOL issue impacts ISR rate base and represents the cumulative impact of NOLs for all years prior to and including FY 2016. Because of its cumulative rate base nature, this NOL issue also has an impact on ISR revenue requirements for fiscal years 2012 through 2015. Consequently, this FY 2016 cumulative revenue requirement impact of $0.8 million and $3.1 million in the Electric and Gas ISRs, respectively, is permanent until the Company can utilize the underlying cumulative tax losses that gave rise to this annual impact. In other words, the Company's current cumulative NOLs will produce a $3.1 million revenue requirement in the FY 2017 Gas ISR and for all future years until such time as the Company is able to utilize its cumulative NOLs. Therefore, deferring an amount of the FY 2016 revenue requirement impact will only result in the need for increased recovery in future years and would result in incremental carrying charges on amounts deferred.

Q. Is the Company seeking to recover in the FY 2016 Electric and Gas ISR plans the revenue requirement impact for all ISR years affected by NOLs?

A. No, it is not. The revised Electric and Gas ISR revenue requirement calculations are addressing the effect of NOLs for FY 2016 only. The inclusion of NOLs in the FY 2016 revised revenue requirement calculation has resulted in an increase to both the Electric and Gas revenue requirements of $0.8 million and $3.1 million, respectively. The Company will be filing reconciliations for its FY 2015 Electric and Gas ISR Plans prior to August 1, 2015 and would address the effect of NOLs related to those FY 2015 plans as part of those reconciliations. The Company estimates that the revenue requirement effect will be approximately $0.8 million and $3.1 million when it reflects NOLs in its FY 2015 Electric and Gas ISR reconciliations this summer. In addition, by excluding NOLs in its FY 2012, FY 2013 and FY 2014 Electric and Gas ISR reconciliation filings, the Company has provided customers with assumed deferred tax cash benefits in excess of those actually realized by the Company on its tax returns for those years. Any plans to address these excess benefits provided to customers for those years, which the Company estimates to be approximately $1.5 million and $3.6 million related to the FY 2012 through FY 2014 Electric and Gas reconciliation filings, would have to be considered as part of the FY 2015 reconciliation filings.

V. CONCLUSION

Q. Does this conclude your testimony?

A. Yes, it does.