

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
Albany on September 19, 2007

COMMISSIONERS PRESENT:

Patricia L. Acampora, Chairwoman
Maureen F. Harris
Robert E. Curry, Jr.
Cheryl A. Buley

CASE 01-M-0075 – In the Matter of the Joint Petition of Niagara Mohawk Holdings, Inc., Niagara Mohawk Power Corporation, National Grid plc and National Grid USA for Approval of Merger Stock Acquisition – Follow-on Merger Credit Compliance Filing and Request for Approval.

ORDER RELATING TO FOLLOW-ON MERGER CREDIT OF THE
SOUTHERN UNION COMPANY IN RHODE ISLAND

(Issued and Effective October 1, 2007)

BY THE COMMISSION:

INTRODUCTION

On January 31, 2007, Niagara Mohawk Holdings, Inc., Niagara Mohawk Power Corporation (Niagara Mohawk or the Company), National Grid plc and National Grid USA (jointly, the Petitioners) filed a Joint Petition proposing a methodology for quantifying the Niagara Mohawk ratepayers' share of the Follow-on Merger Credit related to National Grid USA's August 24, 2006 acquisition of the Southern Union Company (Southern Union) in Rhode Island. The Joint Petition was made as a compliance filing pursuant to the Merger Rate Plan approved by the Commission and in effect for National Grid.¹

¹ Case 01-M-0075, Opinion No. 01-6 (issued December 3, 2001), Joint Proposal, Section 1.2.4.19.

In this Order, we approve the Petitioners' proposal to base the Niagara Mohawk ratepayers' share of the Follow-on Merger Credit on the higher of the estimate included in the Joint Petition as subsequently revised by the Petitioners, or on the final determination of net synergy savings by the Rhode Island Public Utilities Commission (RIPUC).

BACKGROUND

On February 15, 2006, National Grid USA executed a Purchase and Sale Agreement with Southern Union under which National Grid USA agreed to purchase the assets associated with the regulated gas distribution business owned and operated by Southern Union in Rhode Island as the New England Gas Company. National Grid USA designated the Narragansett Electric Company (Narragansett) as the appropriate subsidiary for the purpose of acquiring those assets. On July 25, 2006, the Rhode Island Division of Public Utilities and Carriers (Division) approved the Joint Petition of National Grid USA for the purchase of the New England Gas Company assets of Southern Union.² The transaction closed on August 24, 2006. In the Joint Petition, Narragansett and Southern Union estimated approximately \$19 million in total annual synergy savings. The Division did not make a determination as to the total synergy savings. Narragansett will continue to operate under the terms of the New England Gas Company's existing rate settlement. It is anticipated that a new rate plan will be filed with the Rhode Island Public Utilities Commission ("RIPUC") within one year of the merger and a determination of the synergy savings is expected from the RIPUC in that proceeding.

Under the Merger Rate Plan,³ at the close of any domestic merger or acquisition, Niagara Mohawk is to implement a Follow-on Merger Credit designed to

² Joint Petition for Purchase and Sale of assets by The Narragansett Electric Company and the Southern Union Company in Docket No. D-06-13 (July 25, 2006).

³ Case 01-M-0075, *supra*, Opinion No. 01-6, Joint Proposal, Section 1.2.4.19.

credit ratepayers through the Electric Deferral Account by fifty percent (50%) of the additional synergy savings, net of costs to achieve, produced by the merger or acquisition and allocable to the Company.⁴ The Company is permitted to retain fifty percent (50%) of the net synergy savings by adding that amount back to expenses in its Earnings Sharing Analysis, as described in the Merger Rate Plan.⁵ The credit to the Deferral Account and the application of the Company's share in the Earning Sharing Analysis are effective on the closing of the merger or acquisition and remain in effect through the end of the Merger Rate Plan.⁶ Under the Merger Rate Plan,⁷ the identical procedures and conditions for the Follow-on Merger Credit are applicable to gas operations, except that the ratepayers' fifty percent (50%) share is to be included in the Gas Contingency Reserve Account.

The means of determining synergy savings, cost to achieve, and the allocation of the net synergy savings for the Merger Credit are set forth in Steps 1 – 7 of the Merger Rate Plan.⁸ First, the state commission with jurisdiction over the rates of the acquired utility determines the total synergy savings from the merger or acquisition (Step 1), and those synergy savings are phased-in over a four-year period (Step 2). Next, the one time costs to achieve are calculated and are equal to two times the annual synergy savings (Step 3). The net synergy savings are then allocated to National Grid based on the ratio of its electric and gas transmission and distribution revenues excluding commodity and stranded cost recoveries compared to the same revenues for all of National Grid's affiliates (Step 4). Next, net synergy savings determined in Step 4 are split between electric and gas operations based on the departmental operation and

⁴ Upon expiration of the Merger Rate Plan, ratepayers will be entitled to 100% of the synergy savings under the terms set forth in the Merger Rate Plan, Joint Proposal, Section 1.2.6 and Attachment 10.

⁵ Ibid., Section 1.2.5.2.9.

⁶ In this case, the Company is proposing to begin the credit in the first month following the closing, which would be September 2006.

⁷ Case 01-M-0075, supra, Opinion No. 01-6, Joint Proposal, Section 1.6.1.3.

⁸ Ibid., Attachment 10.

maintenance expenses from the previous year (Step 5). Fifty percent (50%) of the net synergy savings are then allocated to ratepayers by being credited to the Deferral Account for electric operations and to the Contingency Reserve Account for gas operations (Step 6), and the remaining fifty percent (50%) is allocated to stockholders by being reflected as a reduction to net operating income in the earnings calculation for the earnings sharing analysis for both gas and electric operations (Step 7).

COMMENTS

A notice of proposed rulemaking in this case was published in the State Register on June 27, 2007, in accordance with State Administrative Procedure Act §202(1). The deadline for filing comments has passed and no comments were filed.

DISCUSSION

For an out of state utility, the Merger Rate Plan states that the level of synergy savings shall be set at the highest finding by any state commission having jurisdiction over the rates of the acquired utility. In this case, the RIPUC is the agency with such jurisdiction. However, because the RIPUC has not yet made a final synergy savings determination, National Grid proposes to provide the Follow-on Merger Credit based on the Company's estimate of net synergy savings. Once a determination of net synergy savings is made by the RIPUC in connection with the rate filing required to be filed within one year of the merger, National Grid proposes to update the credit to reflect *the higher of* the Company's estimate or the final determination of synergy savings by the RIPUC. Based on the estimated \$19 million of annual synergy savings and \$38 million of onetime costs to achieve, the Company tentatively calculated a Follow-on Merger Credit of \$12,621,371 for electric operations and \$2,495,846 for gas operations for the period September 2006 through December 2011, which is the end of the Merger Rate Plan, as detailed in Attachment A to the Joint Petition.

The Department of Public Service Staff reports that its review of the Company's calculations revealed two errors in determining the 54.49% of follow-on merger savings allocable to Niagara Mohawk ratepayers. First, the Company did not

include actual 2005 revenues related to System Benefit Charges (SBC) for Niagara Mohawk or any affiliated companies in the computation as required by the methodology set forth in the Merger Rate Plan (Attachment 10 of the Joint Proposal). Second, the Company's computation did not include the required Transmission and Distribution (T&D) portion of electric revenues in Niagara Mohawk Subledger Account 109 (Electric Bundled T&D Delivery Charges / CTC). Correcting these omissions resulted in a net decrease of the percentage of follow-on merger savings allocable to National Grid ratepayers from 54.49% to 53.76%. In response to Staff's information requests, the Company agreed with Staff's findings and submitted a revised Follow-on Merger Credit of \$12,622,288 for electric operations and \$2,462,288 for gas operations for the period September 2006 through December 2011. Staff reviewed and is in agreement with the Company's revised computations.

When the RIPUC issues its order on the rate filing to be made during 2007, that order is expected to address, among other things, the determination of synergy savings. To the extent such determination exceeds the \$19 million estimate that forms the basis of the Follow-on Merger Credit and Follow-on Merger Allowance proposed by the Petitioners herein, the Company will update the credit and allowance calculation and will file a revised Follow-on Merger Credit with the Commission, including any true-up to past amounts recorded that would result from the RIPUC's determination of a synergy savings amount greater than \$19 million. Inasmuch as the Follow-on Merger Credit is applied to the Deferral Account for electric operations, and the Deferral Account balance does not accrue interest or a return, any such true-up would not be subject to carrying charges. However, since the Gas Contingency Reserve Account does accrue interest, any such true-up would be subject to carrying charges for gas operations.

CONCLUSION

The Petitioners' proposed methodology for determining both the ratepayers and stockholders share of the net synergy savings related to the Southern Union Company acquisition for the period September 2006 through December 2011 ensures that the highest estimate of synergy savings will accrue to the benefit of ratepayers. We

further find that the revised amounts of net synergy savings allocable to National Grid ratepayers are accurately quantified. Accordingly, the Petitioners' proposed methodology is reasonable and we, therefore, approve it.

The Commission orders:

1. Niagara Mohawk Power Corporation d/b/a National Grid is authorized to initially record electric and gas deferrals for the Follow-on Merger Credit related to the Southern Union acquisition in accordance with the amounts set forth and the discussion in this Order.

2. Niagara Mohawk Power Corporation d/b/a National Grid is required to file a report indicating the level of net synergy savings relating to the Southern Union acquisition determined by the Rhode Island Public Utilities Commission. The report will be made within 90 days of such determination and will contain documentation supporting that Commission's ruling on net synergy savings. To the extent the net synergy savings determined by that Commission is higher than the estimate used in this Order, the Company's filing will also include calculations and supporting work papers as to the quantification of the additional credits due electric and gas customers, as discussed in the body of this Order.

3. Niagara Mohawk Power Corporation d/b/a National Grid is authorized to use the amounts set forth in this Order to determine the stockholders' share of follow-on merger savings related to the Southern Union acquisition. Fifty percent of such amounts will be added back to actual expenses for earnings sharing analysis purposes as set forth in the Merger Rate Plan and discussed in the body of this Order. To the extent the level of net synergy savings determined by the Rhode Island Public Utilities Commission is higher than that contained in this Order, the Company is permitted to reflect the stockholders' fifty percent share of the higher amounts in its excess earnings calculations.

4. Niagara Mohawk Power Corporation d/b/a National Grid shall submit a letter to the Secretary to the Commission within ten days of the issuance of this Order, indicating whether or not it unconditionally accepts the requirements and conditions

contained in this Order. In the event the Company fails to provide said letter, the Commission may revoke or modify this Order.

5. This proceeding is continued.

By the Commission,

(SIGNED)

JACLYN A. BRILLING
Secretary