FINAL TRANSCRIPT

Thomson StreetEvents℠

NGG - National Grid Live Webinar on US Regulation Conference Call

Event Date/Time: Mar. 31. 2010 / 2:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Tom King
National Grid - Executive Director, Electricity Distribution and Generation

Lisa Crutchfield
National Grid - EVP of Regulation and Pricing

CONFERENCE CALL PARTICIPANTS

Andrew Mead
Goldman Sachs - Analyst

Jose Luiz
Exane BNP Paribas - Analyst

Mark Freshney
Credit Suisse - Analyst

Martin Brough
Deutsche Bank - Analyst

Robert Canepa-Anson
Newton Investment Management - Analyst

PRESENTATION

Operator

Good day and welcome to the National Grid live Webinar on US Regulations. Today's conference is being recorded. There will be a question-and-answer session at the end of the presentation. (Operator Instructions).

At this time, I would like to turn the conference over to Tom King, Executive Director, Electricity Distribution and Generation. Please go ahead, sir.

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

Thank you, Saski. Good morning here in the US and good afternoon in the UK. Thank you for joining us today. I would like to welcome everyone to the National Grid US Regulation Webinar.

I am Tom King, National Grid's Executive Director of Electricity Distribution and Generation. And in this role, I oversee all of the regulatory activities for our gas and electric businesses in the US.

Joining me today is Lisa Crutchfield. Lisa is our Executive Vice President of US Regulation and Pricing. Lisa has now been with National Grid for 16 months and has played a significant role in advancing our regulatory efforts here in the US.

Today's objectives will be to update you on our regulatory activities and our progress over the last few years, especially the last 12 months. We're taking action to ensure timely costs and investment recovery, and to ensure we are positioned to earn at least our allowed returns. This action will create a stable business environment that will position National Grid to improve its US operating performance. Achieving a stable regulatory environment and improving US operating performance remains a focus of mine, our management team, and a focus of National Grid.

Now let's get started.

In order for National Grid to deliver value from its US operations, we must operate as efficiently as possible. We must recover our costs and continue to invest in our infrastructure, and earn at least allowed returns as set by our regulators. However, as many of you know, returns from some of our US businesses have declined over the last two years. So why are we not earning our allowed returns?

It has to do with two key factors. We are not fully recovering our cost of service and we are not fully recovering our investments. Therefore, it is clear that our US business requires setting the appropriate regulatory framework going forward in order to make the right investments for our customers. Maintaining our electric and gas network infrastructure is critical to National Grid and is paramount to our customers.

So, to remedy this current business performance, we have been and will continue to file new rate cases in our US, state -- with our US, state and federal regulators to update the cost of service and to change a number of the key rate-making methodologies.

Besides this regulatory action, we are also absolutely focused on our operations, driving toward cost efficiency and toward achieving operational performance excellence. At this point, over half of our rate base is now covered under new rate plans that have been in place, and new rates over the last 18 months. This allows us to ensure our actual costs are reflected in our rates in a more timely manner.

These costs adjustments are for certain changes impacted by exogenous events, such as the recession or the significant change in value of stock indice performance resulting in pension cost impacts. Other rate-making methodologies, such as cost-adjusting mechanisms like a capital tracker, adjust the cost occurred in a period, rather than filing a new case due to one event. All of these actions will assist us in closing our current revenue gaps.

Resetting rates to more appropriate levels should deliver a significant impact in terms of our current revenue levels. For purposes of this discussion, you should think of the term revenue as our cost recovery. This action we have taken to date is adjusting a revenue gap of approximately $600 million on an annual basis in revenue in 2011 compared to 2008.

In addition to closing the revenue gap of this $600 million, we are also filing next month a new revenue proposal for our three Massachusetts gas companies. We recognize that it will take more than one round of rate filings to close the revenue gap. This will be a interim process. However, we will continue until we achieve at least the allowed returns under each of these plans, and that it is an achievement that we believe we will reach within the next several years.

In a few slides, we will discuss in more detail the areas of the regulatory framework required to achieve the appropriate costs and investment recovery. Before that, over the next few slides, I will provide a very quick refresher on the basics of US regulation, which will begin to introduce our various approaches to the required regulatory framework.

US regulation is designed to cover three main elements -- recovery of our cost of service; recovery of our historic and new investment; and an appropriate return on all investments. These are the building blocks of how US regulation sets rates.

The rate base broadly represents the historical capital investment made by the Company less depreciation. Rates are set on an actual rate base and an actual cost of service. Typically, an historic year is used to determine an appropriate level of cost and rate base, stripping out one-off costs that are not expected to recur in the rate year. Typically, the latest 12 months of costs experienced by the Company are used as the base period.

Several jurisdictions allow the Company to make prospective adjustments to the cost that are forecast for known changes. These include inflation, cost efficiency programs, and increased Capex programs.

As we move into a heavy asset investment period -- like the one we will experience over the next decade and beyond -- the historic base period does not allow for proper and timely recoveries of our costs and the cash invested. The rate base is an important part of setting revenues and measuring returns. The rate base roll-forward is relatively simple -- we calculate the rate basis on our US companies annually. The calculation is done at each calendar year-end and is disclosed in our year-end results statement. At December 31, 2008, the combined rate basis for our regulated US companies was approximately $15.5 billion, excluding stranded costs.

Many of the principles of US regulation are similar to those in the UK, but there are some differences which we expect to continue for the foreseeable future. A few key ones include -- most US regulation is based on historic cost review; whereas the UK is based on a prospective cost review. US regulation allows a company to file for new rates when necessary as opposed to the UK system, where it would be extremely unusual for a price control to be reopened early.

There are circumstances in the US which allow for partial filing of an element of a rate plan; whereas in the UK, requires the whole plan to be reviewed. Also, UK rate plans allow for real returns in revenues, inflation on the rate base, and inflation protection in revenues; whereas the US plans tend to deliver nominal returns via revenues, but no inflation on revenues for the rate base.

Finally, the US actual capital structure is important; whereas the UK assumes a capital structure in setting rates. In the US, some regulators will look to the overall actual capital structure of the group if the company capital structure is out of line. As part of our filings, we are submitting a capital structure at which our operating companies currently hold at the operating level. This currently tends to be about 50% equity, 50% debt, depending on the entity. The 50%/50% structure of equity to debt is also a US industry standard that regulators look for.

A big difference between the US and the UK is the fact that we perform as the energy delivery company, and also, in some instances, act as a supplier of a large number of retail customers in the US; whereas in the UK, we have no supply obligation at all. The UK primarily acts as a wholesale transporter.

So, our state regulators are looking at the total utility bill impact on each decision they make. In the US, we have roughly 8 million gas and electric distribution customers that we bill directly, which includes the cost of commodity and other state policy programs. National Grid has no earnings tied to these state programs. And we do not take commodity risk or any earnings in relation to our US supply obligations, as we pass it through the commodity costs to our customers.

In the UK, although our electric and gas system extend to the entire nation's consumers, these consumers do not see a bill from National Grid. Consumers only see a bill from their supplier. In our US operations, we therefore face broad bill pressure in terms of publicity and political pressure for our rate filings as it relates to the total bill for customers. This total bill, as I've mentioned, does come from National Grid, and customers look to us for the reason of any increase in the part of the -- of any part of the bill.

This slide demonstrates the four key sources of our return erosion. First, volume reduction, and we've seen a decrease in volumes, both through the economic recession and through conservation efforts. Second, an increase in capital investments to ensure our network reliability. Third, bad debt -- again, a result of the economic recession, which is billed consumption, billed revenue, but not collected. And then, finally, an increase in pension costs and healthcare expenses.

As mentioned earlier, we are also working to shift the historical regulatory practice with our proposals as we file them. Specifically, our proposed structural changes and the new rate plans are intended to ensure that the new rates do not become outdated so quickly in the future. This saves the Company time and resources, and the Commission time and resources, by not having us -- by not seeing us return with rate changes so soon after the new rates go into effect.

There are five main areas that we are proposing framework changes -- pension and healthcare costs, and environmental remediation costs. All of our regulators make an allowance for these costs and typically provide full recovery. The main change we're proposing is to allow for an annual reconciliation to reflect the cost and market changes in order to ensure that we do not bear the risk of over and under-spend in pensions and healthcare remediation, and environmental remediation costs.

Bad debts occur when the customer does not pay their bill. Regulators look to utilities to recover as much revenue as possible from these customers as appropriate. We believe that our exposure should be limited to the delivery cost portion of the bad debt, and that all other elements, particularly the commodity element, should not be our burden. This reduces the volatility of bad debts.

Storm costs, again, are generally an allowable cost. When there is a large storm, such as the ice storms we saw in 2008, the utility incurs significant extra cost. Our goal in relation to these extra costs is to gain stronger regulatory support to recover these costs in a much more reasonable time period. The volumes -- we are obtaining regulatory support to decouple our volumes from revenue, or, within our cost recovery. We will have all of our New York and Massachusetts businesses under decoupling structures by the end of 2010. Only Rhode Island and New Hampshire have been slow to act on decoupling.

And the capital investment. When we undertake a US-wide look at our current network system conditions, we have been very focused on not only the system conditions, but where we think we need to be making the investment. And where we have had concerns about the system performance, we are sure -- and are sure to deliver on our customer reliability, we have been investing. In each of our filings, we will true up our investment that have been in excess of the capital funded under our historic rate plans.

There are a number of mechanisms we are suggesting to address the issues of this noncontrollable cost and regulatory lag. First, deferrals. Deferrals are used by the regulator to employ a gradualism of costs in order to mitigate rate impacts. This mechanism allows -- also works for US utilities who are under US GAAP. However, it does not allow for a timely cost recovery, and we are working to ensure this mechanism is used sparingly. True-ups recover additional costs in revenue under recoveries with usually a one-year lag. Therefore, they are more certain in timing than deferrals. Some true-ups are monthly or quarterly.

Trackers. Trackers are typically used for recovery of Capex. In the case of the Massachusetts electric filing, the tracker compensates by adjusting revenues within the following 15 months and then placed into rate base.

Decoupling. Decoupling allows prices to be changed within a year to recover as close to the correct amount of allowed revenues or cost recovery as possible, with any residual under or over-recovery being carried forward in later years. This is particularly important with the focus on climate change and promoting energy efficiency to ensure conservation within consumption.

So each of these mechanisms are now submitted as part of our new rate cases. Again, as the mechanisms are approved as part of the new regulatory structure, they will step us in a direction of sustainable regulatory outcomes.

Each of the rate filings are allowing us to reset the base cost structure and are introducing a sustainable regulatory framework. I would also like to point out that as we undertake these new rate filings, we are also doing so within two years of very positive operating performance.

Again, in 2009, we will not pay any performance penalties, as we have met all of our reliability and customer performance goals as set by the regulators. We have increased our reliability of performance; we have increased our customer service performance; and we have increased our performance on energy efficiency and other green energy initiatives. This allows us to demonstrate our commitment to customers.

We expect regulators to examine these costs in detail, and we believe that the proposals for setting the new cost of service levels and the regulatory mechanisms are moving us in the right direction. In fact, sitting here today, we have delivered an increase in revenues of $193 million in the US, and we have two important cases this year -- the Niagara Mohawk Electric case and the three Massachusetts gas cases. So, by the end of 2010, we will take another major leap forward in closing the revenue gap.

Now we have identified solutions which will frame out our regulatory structures and the key rate -- and each of the key rate plans where we're now setting new costs and new volume levels.

So I will now hand over to Lisa to run you through the current status of implementing these solutions in our rate cases. Lisa?

Lisa Crutchfield - *National Grid - EVP of Regulation and Pricing*

Thank you, Tom, and good day to all who have joined us. As Tom shared with you, we continue to make progress setting new rates and moving the regulatory agenda forward in the US.

On page 15 of your presentation, this chart shows progress we've made in the US, with approximately 57% of National Grid's asset base having new rates set since 2008. For a number of the companies, it may take several rate filings for the regulators to approve the appropriate framework to enable us to get timely recovery of costs and to earn a fair return for investors, especially in light of the economy in the US.

As shown on the chart, our current US rate base is $15.5 billion, and we show the percent contribution of each one of the operating utilities. At the top of our previously agreed list, we reference the transmission companies -- New England Power, Rhode Island Electric, and Canadian Interconnector, which are regulated by FERC and have formula rates which are reset each year. We're pleased with the regulatory framework at FERC, which enables us to invest in the network and to earn at least the allowed rate of return.

Such rate structures enable the Company to properly invest in the infrastructure, ensuring we're meeting customers' needs for safe and reliable service.

The other companies listed in the top half of the chart had their rates reset in 2008 or 2009. The remaining 43% of the asset base listed in the bottom half of the chart represent rate plans that we filed in 2009 and are waiting for a decision, and for companies where we plan to file their cases in the near future.

In January, we filed a major rate case for Niagara Mohawk Electric, requesting an increase in revenue of $391 million. I'll discuss that a bit later.

Also in February, we filed a new rate case in New Hampshire for Energy North, to address our need to recover new capital investment made in 2008 and 2009.

We've received a preliminary oral decision in Rhode Island for Narragansett Electric, representing 3.5% of our rate base. We're not pleased with this decision, as the funding levels approved for both operating and capital programs were reduced. Before we finalize our next steps in Rhode Island, we're waiting for a written order from the Commission. We believe this may be partly driven -- their decision was partly driven by the economic environment in Rhode Island, which has high unemployment, but we will talk about our next steps in Rhode Island a bit later.

On page 16, this calendar shows the current status of our US rate plans. I'd like to focus on the plans highlighted in yellow. I'll start with New Hampshire, which is 1% of the asset base.

As you may be call, we filed the case in 2008 and received a decision in June 2009. We were challenged by the decision, primarily because we were awarded an ROE of 9.54%, which is 100 basis points below the industry average. We filed a new case in February of this year with new rates to take effect February 2011. We're seeking an $11.4 million increase to cover increasing operating costs and capital investments. Under New Hampshire's rules, we are allowed a temporary rate increase of 50%, which may become effective in June of this year.

The biggest rate plan we worked on this year is for upstate New York. It represents 23% of our rate base. We filed this plan on January 29 of 2010, and we're anticipating a decision from the Commission in December of this year, with rates effective January 1, 2011.

We also plan to file, as Tom mentioned, a rate case for three of the Massachusetts gas utilities, which represent [15%] of our rate base. I'll go into more detail shortly. That case we're planning to file in April, and we expect a decision and effective rates to take effect November 1, 2010.

In addition to these filings, we're currently evaluating our operating Company's financial performance and may be filing for updated plans where we're not earning the allowed return for other companies.

Now let's go to page 17. So, when we start to see the impact -- when will we start to see the impact of new rates? This chart represents the percent of our rate base that we expect to have at least one full calendar year of operating earnings under updated rates when we report our results, which our results are as of year-end March 31.

For example, results reported March 31, 2009 represent 34% of our rate cases operated under new rates for the entire year of 2008. This includes the FERC contracts, which will continue to adjust each year, and it includes our downstate New York company. And for March 31, 2010, we will add a full year of earnings for the Rhode Island gas plan, which is 2% of the rate base which took effect December of 2008.

For March 31 of next year, we'll be able to add another 22% to that 36% for a total of [58%], when we have a full year of operation for Niagara Mohawk Gas, Massachusetts Electric, and Long Island Generation. Please note that we haven't recognized New Hampshire Gas primarily because we just filed a new case for them.

As both Tom and I have said, it takes several iterations with the regulators to get the appropriate framework in place to earn our allowed returns, especially in light of the economic environment. So there may be other cases that we'll file in addition to New Hampshire and we'll keep you apprised of new -- our plans for new filings.

Now let's discuss the rate order we received from Massachusetts Electric, with rates going into effect January 1, 2010, which represents 10% of our rate base. This is the first electric distribution rate plan for Massachusetts Electric since 1999. It's a one-year plan, where the Department of Public Utilities in Massachusetts granted us an increase of $44 million in revenue, and an additional $24 million over the next four years for storm fund recovery.

This approved revenue increase represents a 61% of the request, which is comparable to the industry average in the US. And our awarded ROE of 10.35% is in line with the industry average. That's applied on a rate base of $1.5 billion. We're pleased with the Commission's ruling. They ruled on and granted us full revenue decoupling, which recognizes -- and reconciles actual billed revenues to an annual target amount to account for lost revenues from energy efficiency programs, demand response, and distributed resources. This mechanism will reconcile on annual basis, and rates will adjust up or down in the following year, based on actual volumes.

We expect to continue to ramp up our energy efficiency programs in Massachusetts over the next several years, and we also earn additional incentives for doing that. Additionally, we are able to reconcile for pension and OPEP costs and commodity-related bad debts.

We were awarded a capital tracker in Massachusetts. We can spend up to $170 million per year, net of the annual depreciation allowance. Again, this is a step in the right direction. We requested funding higher than the $170 million, so we will, at this point, have to adjust our investment plan in Massachusetts down to the approved level, and we will be analyzing the impact on our system reliability going forward.

However, overall, Massachusetts Electric received a good decision. It provides a sustainable foundation for infrastructure investment, cost recovery, and the reliability of the network. In addition, it allows us to aggressively pursue energy efficiency and help our customers lower their overall bill.

Now let's go to page 19. This table contains some of our recent regulatory decisions. Most recently, FERC updated our generation rates for Long Island. We were pleased that we were provided an 18% increase in revenues and a 10.75 ROE on a cash structure of 50/50.

On the distribution plans, we're allowed over 10% ROEs in upstate New York for gas and our Rhode Island gas company. We, as I mentioned, are challenged by the New Hampshire Gas Company ROE allowance of 9.54%. We received full revenue decoupling in New York and we also received revenue decoupling for Massachusetts.

In all three cases, the -- for the New York companies, we also received allowances for bad debt and environmental remediation true-ups. We can true-up pension and OPEP costs in New York and in Rhode Island, and we have a capital tracker in Rhode Island for our Cast Iron Bare Steel Main Replacement Program. Even though we didn't get everything we requested, we're making progress. We stated earlier, we will make several filings -- this will be several iterations to ensure that we get the proper framework and are allowed to earn the required ROE in each state.

Now let's talk about Niagara Mohawk, the filing we made on January 29. As most of you know, the current rate agreement was adopted in 2001. It provided for limited updating of expenses through deferral accounts and it established the delivery rates from that point.

So we're under-recovering our costs for Niagara Mohawk Electric. Our 2008 ROE was reported at 6.7%. The low returns were driven by the fact that our Capex has been above the assumed level set embraced in 2001. We spent $750 million above the rate plan. And $750 million is a portion of the $1.47 billion that we received a commission order in 2007, indicating that we needed to make more investment in the -- capital investment in the network.

Volumes also have been lower than forecasted levels. As a result, we're not recovering what we had anticipated in terms of revenue. At the same time, our rate base is growing. For Niagara Mohawk, which represents 60% -- for Niagara Mohawk, this represents 60% of the revenue increase that we're requesting in our case.

Despite the increase in efficiency, operating costs have increased as well. We have higher bad debt, higher pension and OPEP expenses; we've absorbed inflation; and we are carrying the cost of the increased Capex. We expect the regulators to examine all of these costs in detail in the case we filed on January 29, but we believe that the arguments for resetting rates to fully recover these costs are very strong.

On page 21, we outlined the elements of the case. We believe that the case we submitted to the New York Public Service Commission, which is a comprehensive three-year plan, will allow the Company to continue to make its investment in the distribution and transmission system, and meet the changing needs of our customers while earning a fair return. We're requesting $390 million in the first year of additional revenue. We also have requested an ROE of 11.2% on a cap structure of 50/50. The plan also includes an infrastructure investment program of approximately $600 million per year.

Understanding the economic environment, we are holding customer rates constant by reshaping stranded costs. I'll talk about that in just a second. Additionally, we are asking for full decoupling, a reconciliation mechanism for pension in OPEP, commodity bad debt, and a capital tracker.

As we said, the Company recognizes the difficult economic climate we operate in today. At the same time, we need to make improvements to the infrastructure and prepare our networks for new state and federal energy policy. This is why our three-year plan for Niagara Mohawk, we are proposing to mitigate customer rate impacts by deferring stranded costs.

Stranded costs are related to the sale of [Nine Mile Two] nuclear power plants and some on economic independent power producer contracts, which we began recovering on an accelerated basis for a 10-year period from 2002 through 2011. In 2011, we had planned to collect close to $600 million in stranded cost revenue, which is the last year of the merger joint proposal for Niagara Mohawk.

As we show in this chart in green, we're taking this last year of stranded costs and reshaping it, extending it to recover it through 2014. That's allowing us to increase our base rates by $391 million. This step-up is shown in gray. This ensures that customers will not see a delivery rate increase until after the period of time of the rate plan. We are hopeful that the plan we filed satisfies regulators as well as our customers.

As for the Massachusetts Gas Company filings, we are planning to file this case for the three companies which represent 15% of our rate base. Boston Gas and Essex Gas are currently being consolidated. We will file a rate case, which will be one proceeding, but for two companies. And both of these cases in addition to asking to update our rate base, we are asking to have full revenue decoupling, and some trackers and true-ups, as Tom mentioned earlier.

So, I hope that is a clear explanation of what we have filed this year. And why don't I turn it back to Tom.

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

Great. Thank you, Lisa. We'd now like to hand it over to the Operator, who will help us facilitate the questions from the audience and we'll provide the answers.

So, Operator, if you could pick it up and help us facilitate the Q&A, would be great.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Andrew Mead, Goldman Sachs.

Andrew Mead - *Goldman Sachs - Analyst*

Just two questions. One on the awarded revenue side on page 5. The awarded amount, $193 million, what was that as a percentage of what you filed for?

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

We would need to go case-by-case. And Lisa, do you have those percentages right in front of you? Aside from the percentages, we can go down and just kind of give you a sense of it.

The generation case was filed for roughly around $95 million and we were rewarded $65 million. Rhode Island was, as adjusted for accounting requirements, was roughly around $64 million, $65 million, and you see the 24. Massachusetts Electric was $74 million? Well, yes, that's right -- $111 million. And embedded in the decision was $44 million in the cost, plus $30 million of recovery and storm. So the $30 million is spread over five years, so it's an incremental revenue increase of $5 million over the next -- $6 million over the next five years, added to the $44 million. So we've got -- so we're roughly at $74 million of cost recovery compared to the $111 million.

And I do not have the Niagara Mohawk gas cases in Rhode Island. The New Hampshire case I know was roughly about $10 million and we achieved $6 million of that. Do you have the other two gas cases?

Lisa Crutchfield - *National Grid - EVP of Regulation and Pricing*

Yes. So, on page 19 of the presentation, we have Rhode Island Gas, which we requested $18 million, okay? (multiple speakers)

Andrew Mead - *Goldman Sachs - Analyst*

On that slide, sir, on that slide thing, you've got the $391 million filed. And then you said that [580] as far as Massachusetts. But the two aren't quite comparable, are they? And that doesn't make your $600 million gas [up].

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

No. I would look at the Niagara Mohawk case differently. First of all, we have not been in for 10 years. If you go back through the slide that Lisa went through, on the key elements of the case, which is on slide 20, which makes up the key elements -- Andrew, I'm glad you're asking it the way you are.

First of all, of the $390 million, keep in mind that the structure and the proposal that we went in with, does not require the Commission to be in a position where it has to make a ruling that increases rates, because we're smoothing the stranded costs. So with the way we've handled the smoothing of the stranded costs and the add-in of the $390 million, we've been able to make a proposal that allows for the delivery rates to stay constant over the next four years, not increase. So that's number one.

Then you go back through the key elements, we'll have a discussion around the operating and maintenance, and we have very clear issues that we will present in our testimony to support the $120 million in the O&M. On the volumes, is really a decoupling issue, which New York has a history of awarding and aligning with decoupling. So that will be a true-up in our billing determinants that allows us to recover that $130 million.

Then the Capex. We have two issues there. One is we continue to invest this system to ensure reliability. The second is, as you are likely aware of, we've had two-plus years of a discussion with the Commission around the asset condition assessment of the upstate electric system, and an initial order from them in late 2007, early 2008, agreeing that the investment needed to be made, and approving the $1.47 billion on -- which they'd look at on an annual basis. So I think a good piece of the historic Capex will come in.

And then the next key element will be where did they set the appropriate return within that decision? So I think for a whole host of reasons, we can look at the Niagara Mohawk Electric filing differently than the others. And I think we've got a very good case to try to recover as much of that as possible.

Andrew Mead - *Goldman Sachs - Analyst*

And then my second question, which I'll state briefly, when you're looking at your ROE, and in your new rate cases, the ones that you've achieved to date, in terms of delivery of that ROE, how much or how many of them require you to reduce your costs to match the decision? Or how many of them will be instant and how many will require you, say 12, 18 months to work through?

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

Okay. All of them -- the approach that we're taking on each of these cases is to reach the ROE as soon as possible. And we're finding that it's typically taking us about a year. And what we're finding is for those decisions that are made below the request, it requires us to come back and look at the investment requirements and the costs in detail, so we can do our best to match what's the allowed cost of service and the investment.

If we have concerns within that cost assessment that we view that we're putting the system reliability at risk, then we'll go ahead and make that investment in order to ensure that we're meeting our reliability objectives, and at the same time, investing in the system to ensure that the integrity of the system is there. If that's required, that's a key element of what is causing us to go back in very quickly and refile.

So we're doing a number of things. We're taking action immediately to try to live within the means of the decision, number one. Number two is, as you see from hearing from Lisa as well as the other actions in the rate cases, we're going in quickly, to make sure that we're, on a much more frequent basis, truing up the cost of what we're actually experiencing.

And then the third element of it is -- we are continuing to advance forward on our US transformation efforts that are both a cost efficiency effort as well as a performance effort, to continue to move us in the direction of operational excellence. So we're not just viewing it just as a regulatory strategy; we're also looking at it to ensure that we fundamentally are driving this business to a much more efficient operating structure. So it's a whole host of things that we're running in tangent with the decision.

Andrew Mead - *Goldman Sachs - Analyst*

Okay, thank you.

Operator

Jose Luiz, Exane BNP Paribas.

Jose Luiz - *Exane BNP Paribas - Analyst*

I would like you to help me to see how I should react when you make an announcement of a decision by the regulator. We normally look at the return on equity, but this is basically a signification when I think we should look also to true-ups, decouplings.

And I'm trying to understand what would be the importance of that? I mean, if I look at slide number 19, if I compare Rhode Island Gas, where there is no decoupling, with upstate New York, where there is decoupling, and the return on equity side is pretty much similar, could you help us to tell in terms of why the -- which one is better in terms of achieving a good return? Thank you.

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

Yes, I'd be happy to. And what I'd like to do is, first, direct you back to an earlier point that I made. And that is around the importance of how we're approaching this, both with the regulator as well as our view on it. So, ultimately, to answer your question, the best regulatory structure that gives us recovery of our costs, that allows us recovery of both the historic and new investment, and gives us a competitive return, those are the things that we're absolutely focused on.

In addition to that, we're moving in the direction of gaining, which is back to your point on 19, is gaining the appropriate regulatory structure to ensure real-time true-up of the Capex, bad debts, pensions, et cetera. And those are all the cost elements that we don't have direct control over.

So what we're doing is we're managing our direct costs, and for those that we don't have direct control over, we're putting regulatory mechanisms that allow us to true-up on a much more frequent basis. So when you look at the whole as far as the ability to recover a cost, the investment, and a sustainable return around the regulatory structures, and then apply it to 19, they were both good decisions.

However, there's two elements that are different between the two of them. One of them is Rhode Island has not embraced decoupling. So what that means is, as we continue to deliver on our energy efficiency and conservation programs, we're eroding the volume -- which means that that structure is not allowing us real-time cost recovery. That's one element of it.

The second is Rhode Island continues to be in a negative economic environment. So as it continues to struggle economically and we're successful in delivering energy efficiency, we now have a billing determinant that doesn't match what's required to get our cost recovery. So that will be something that we'll clearly stay focused on, and continue to educate Rhode Island on the importance of it, and we'll have our ability to do that when we go back in and rethink the electric case.

Then you look at New York -- as you are well aware of, probably the biggest adjustment that we have in New York that we didn't get that we need, is the Capex tracker. And within the aged infrastructure and the gas system, we need to spend the capital to ensure that the system performs and has good structural integrity behind it. So we have to deliver on that. We have to make sure the infrastructure is there, but we have a regulatory mechanism that causes a regulatory lag on recovery of that capital.

So they're all different; but hopefully, that gives you a better sense of why the structure is just as important as the approval of the cost levels and the ROE.

Operator

(Operator Instructions). Mark Freshney, Credit Suisse.

Mark Freshney - *Credit Suisse - Analyst*

It's Mark Freshney from Credit Suisse. I just have two questions. Firstly, on the upcoming Mass gas rate reviews. I think -- it's very, very rare for capitalized goodwill to be added to the rate base. And I understand that's something you're potentially looking at for the consolidation of those three businesses.

And I guess my second question is just on the returns on equity. For the US business as a whole, what is your current return on equity? What do you think you can get to? And is there potentially -- these rate reviews seem to be potentially capping your upside on the return on equity as well. Is that true?

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

I'm going to jump in and answer the second half and then hand it over to Lisa to deal with the gas cases.

The most current year that we reported I believe our return is around 8%, 8.5% across the US business. Very likely to see a repeat of that, because as Lisa walked you through, when each of the decisions are made and how is that -- those decisions going to ultimately roll into our performance years. And you can see each year going forward of how we're going to continue to improve upon it.

So, ultimately, if we continue to take the action and move in the direction, both from an operational performance and the regulatory outcome, within a very reasonable time period, within the next year or two, you're going to see us move in the direction where we're starting to deliver those industry-standard returns of 10% to 10.5%. So that gives you a sense of when that will happen.

As to the question as far as capping the upside, I think the reality of where we are right now and the pace that we have through our regulatory, we're fundamentally not recovering our costs and our investment. So that's causing us to under-earn on the ROEs. And we're also not prohibited of continuing to go in and file the cases and think through the structure.

So our focus, Mark, immediately has been to let's get ourselves into the right cost recovery; let's get ourselves to the point where we're recovering the investment and earning at least the standard returns, and then we'll begin to address the upside. So I don't believe that we've closed the door on the upside.

What we are focused on is making sure that we can even get through the door and deliver the industry standard returns. And that's the key objective over the next couple of years. And then we'll take the performance issue even further from there, once we get to the fundamental recovery.

So, Lisa, on that Mass?

Lisa Crutchfield - *National Grid - EVP of Regulation and Pricing*

Sure. Thanks, Tom. We're optimistic about the Massachusetts Gas cases. The components of the filing really match the policy decisions the Massachusetts Department of Public Utility have been making in at least the past 18 months.

The question around goodwill -- I'll direct you specifically to the Colonial Gas Company. When Eastern Utilities acquired the Colonial Gas Company, they paid an acquisition premium in excess of $300 million. That acquisition premium, however, was given very beneficial treatment by the Massachusetts DPU. And over the next 40 years -- or over the 40-year period after the acquisition, the company is able to include up to a $12.3 million acquisition premium benefit, a benefit to the company, in our cost of service.

So you will see in our filings that they will be requesting to add $12.3 million of value to our revenue requirements. That should be approved and we will be allowed to recover that for the next 30 years. So for the treatment of goodwill, it's a unique feature but very beneficial in the Massachusetts environment.

To your question about ROEs, just want to provide you an update on what are the industry averages in the US. So for the gas business, the current industry average awarded ROEs of 10.2%; and for electric utilities, it's 10.48%. So we're hopeful that we'll get reasonable treatment and get ROE allowance comparable to the industry average.

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

And another data point on that. I think that's relative to about 95 gas and electric cases over the last 12 months. So it just gives you a sense of the size and -- or really the number of cases that the -- from a national standpoint, significant increase in cases; significant capital program that's happening nationally. So it's a national trend for the utilities to go in and file the cases. And that just gives you a bit of a benchmark on where the various jurisdictions are coming out on the decisions between gas and electric.

Mark Freshney - *Credit Suisse - Analyst*

Just another thing that occurred to me -- I mean, it appears that you deal with four key regulators in the US plus FERC. So you've got the four PUCs. It seems like things are going much better and the precedents are much better with the New York and Massachusetts ones. And then you've got the smaller businesses in Rhode Island, where it's apparent you're being almost -- you're having to take your share of the problems that they've got economically. And I guess New Hampshire.

I mean, does that raise the specter that some of the smaller businesses might be seen as less core, and that those ones -- most of the value that you're adding for shareholders is in Massachusetts and Niagara Mohawk, i.e., with these smaller businesses, the opportunity or the potential that you'll do something with them, or --?

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

Sure, I mean, that's a reasonable conclusion. Ultimately, the way I think it would be helpful for you to think through this is, one of the benefits that we have in the US is we have 16, I believe -- I'd need to verify that -- but 16 different regulated entities.

And the direction that we're taking on this is we're going to look at those as distinct operating companies. And if they're not delivering the performance that we think they should be delivering, we'll either fix it through the regulatory or operational component, or we need to assess whether it needs to stay -- remain in the portfolio.

So we will be -- our intent is through the regulatory strategy, the operational performance, and portfolio management, that we will ensure over time that this group of entities within the US get to the point where they're delivering shareholder value, or they will not be part of the portfolio.

Mark Freshney - *Credit Suisse - Analyst*

Is there a time frame that you could give on that? I mean, is it one year or --?

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

No, there's no timeframe; but I can -- how about if I give you assurance we're actively addressing it and we'll take action as soon as it becomes clear to us.

Mark Freshney - *Credit Suisse - Analyst*

Okay, thank you.

Operator

Martin Brough, Deutsche Bank.

Martin Brough - *Deutsche Bank - Analyst*

I wanted to ask you a question about the treatment of taxable interest costs in the rate cases. As you say, you've got a lot of different discreet entities, but you also have some debt held more at group level or various different holding company levels. And obviously, some of the tax benefits could come through at those levels as well.

How have regulators -- what's their attitude been to the fact that these entities are all in a bigger group? And I guess have they been keen to try to get their hands on any of the potential benefits that might arise outside of the regulated companies?

And related to that, I guess, how has their attitude changed over time, if at all, on the appropriate debt equity mix in the right base?

Lisa Crutchfield - *National Grid - EVP of Regulation and Pricing*

So, good question and I'll start out by repeating something that Tom shared with you earlier, and that is, the industry average debt to equity used across the US is about 50/50.

When we began our journey of filing rate cases in 2008 and early 2009, we recognized that a number of the operating companies that we were filing the cases for had more equity than the target 50%. So, National Grid Treasury has now gone about recapitalizing those companies, so that we would have actual cap structures commiserate with the industry averages.

However, what has happened, because we had imbalances in our cap structure where we had more equity than was appropriate, New York, in the New York gas -- the Niagara Mohawk gas case, did look to the parent cap structure, but we were able to negotiate some adjustments. So the cap structure in New York was -- the equity component was less than 50%.

In Massachusetts, we still have a motion out for clarification, but Massachusetts basically affirmed our intent to recapitalize the Massachusetts Electric Company and gave us an equity component of close to 50%.

In New Hampshire, they compute cap structures, so for both New Hampshire companies, Energy North and Granite, they impute a 50/50 cap structure.

And in Rhode Island, we were, in the Narragansett gas case, also able to impute a cap structure. But in the most recent Rhode Island electric oral decision -- we haven't had a written decision come out -- the Commission was unclear. And so they came up with a potential cap structure that was in between the parent and the target 50/50 cap structure.

So what we are trying to do is get most of the operating companies in the US at about a 48% to 50% equity cap structure, and clearly argue that that is the appropriate cap structure as well as weighted average cost of capital based on the cost of debt and equity in the US.

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

At the operating company --

Lisa Crutchfield - *National Grid - EVP of Regulation and Pricing*

At the operating company level, not at the group level.

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

Yes. And the typical -- and by the way, for Niagara Mohawk Electric as filed, we were close to the 50/50 also, because we recapitalized that entity before we filed.

The typical practice by the regulators across the US has been both the preference around the 50/50; and they also, if you're able to establish that at the operating company, they prefer -- which really allows us to tie both the cost of service and the performance of that entity back to the operating entity, and they prefer to make the decision around that.

So I think we've really -- this is, again, talk about a leap, within 18 months, we've made a major leap with significant help from our excellent team, the National Grid Treasury team, of recapitalizing these entities. And we're making some pretty strong, compelling positions of why they should make the decision at the operating company. And that ultimately will deliver some value to them long-term.

Martin Brough - *Deutsche Bank - Analyst*

Okay, thanks. Could I just ask, I guess the related thing about the tax side of that, because I would have thought the tax in some ways could be even more significant, in terms of differences between the group and the operating company.

Lisa Crutchfield - *National Grid - EVP of Regulation and Pricing*

And so for tax -- the actual operating company income tax obligation is included in the cost of service. So it's -- at the local company level, they do not look at the parent's tax benefits.

Martin Brough - *Deutsche Bank - Analyst*

Okay, thanks.

Operator

Robert Canepa-Anson, Newton Investment Management.

Robert Canepa-Anson - *Newton Investment Management - Analyst*

I had a couple of questions. One, I just wanted to check, given all the information you've been telling us how to put it into practice. So firstly, if all this revenue, you know, what stuff you've been allowed plus what you're also filing -- that's the only topline movement that we're seeing at the moment, volume growth being what it is. And then a quick question -- what's been going on in your operating costs line?

And then as a last to the points, you seem to be steering us towards maybe March 2008 or March 2009 as a basis here to look back on to apply these revenue increases. I just wondered if you could talk us through were there sort of -- were there any sort of one-off impact in those numbers that we should strip out to get to an underlying clean number, because of the swings in UK GAAP on the storm cost recovery and things like that? Thanks.

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

Yes. No, there isn't anything that you can directly point to on what was magical as to the March 2008, 2009. No one-offs. It primarily related to late 2007, early 2008, both from the aggregate of the investment, the volume erosion, bad debts, because the recession absolutely kicked in by then. [That was] an aggregate is where we were underperforming, which was typically in most instances in year six, seven of the ten-year plans. So it's just been a -- the issues that I listed out, that Lisa listed out and I listed out, on where the key elements that are causing the ROE and the value erosion, it's due to those. And those are clearly identified starting to see in late 2007, 2008. So from an event standpoint, nothing specific there.

As it relates to the operating costs aspect of it, absolute focus on that. I am pleased to say that when you look at the overall performance from 2008 to 2009 -- and those would be calendar years, which we could easily pick up in FY '10 -- that we were able to start to see the benefits of our efforts around cost management and operating costs. Year-over-year, I think, we've been able to hold it flat under very, very strenuous circumstances. And that strenuous being increase in Capex, healthcare costs continuing to go up, bad debt costs continuing to go up, et cetera, but we've been able to keep the operating costs relatively flat.

So as we go into FY '11, that's absolutely the objective, and to continue to implement the initiatives that we're doing on our cost management, to continue to push those costs down. So the cost, operating cost piece -- tremendous amount of time and energy is going into that, to ensure that not only are we performing on the cost management, we're building some robust metrics on benchmarking, to ensure that we're hitting and exceeding the benchmarking data. So that's the issue on the costs.

On volume growth, if you look at it from an overall policy objective, looking forward, the intent around the policy -- and I'll stick, certainly, directly with New York and Massachusetts, since those were the largest volume and the larger businesses -- the policy objectives that the Commissions have set is to at least offset any volume movement by 50% through energy efficiency and conservation.

We haven't necessarily had to use those tools, even though we're implementing daily energy efficiency and conservation, because they're just the fundamental volume reduction due to the recession. So as we come out of the recession and begin to see businesses pick back up, there will be a very significant focus on offsetting any volume growth through energy efficiency and conservation, which is both a New York and Massachusetts state policy objective.

So that leads us directly into decoupling. So the ability for us to ensure that we have a decoupling structure allows us to have the appropriate billing determinants to ensure that we are recovering our costs.

So finally, to move back over to the issue on the revenue component versus the volume, the revenue component that we're delivering, the $193 million plus the additional cases that we have filed for 2010, all of those ultimately flow directly to the bottom line, because they're -- what we're doing today is we're subsidizing that gap. That's why we're having the P&L impact and the ROE erosion.

So as the revenues flow from the decisions, they're an absolute -- not only are they topline, they're an absolute uplift in the overall financial performance of each of the entities. Hopefully, that was responsive.

Operator

(Operator Instructions). At the moment, there is no further -- pardon the interruption. There is just one question came in from Mark Freshney of Credit Suisse.

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

Okay. So, Saski, we'll take this as the last question.

Mark Freshney - *Credit Suisse - Analyst*

Okay. So just very quickly, on the pushing out of the stranded costs, will that be done in an NPV-neutral way?

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

Yes, it is an NPV-neutral way. Ultimately, the way the deferral account works with the stranded sets is, we'll continue to earn our weighted average cost of capital on those funds. So the current balance, I believe, was around $560 million, $570 million. We'll spread that out for three years, but we'll continue to earn on those as we recover them over a longer time period. So it is MPV-neutral.

Mark Freshney - *Credit Suisse - Analyst*

Okay, super. Thank you.

Tom King - *National Grid - Executive Director, Electricity Distribution and Generation*

Okay, thank you. And I'd like to close out by, first of all, thanking everyone for attending and listening. We hope that this has been helpful.

We would really like to have your feedback as you talk with our team over the next few days. We'll continue to do this, and make sure that you're not only aware of the details, but we're providing strong explanations of why we're taking the initiatives that we're taking here in the US. And our intent was just to bring everyone up to speed, and we'll continue to keep the dialogue flowing. So thank you very much.

Operator

That will conclude today's conference call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.
