A conversation with Tom King & Lisa Crutchfield

US Regulation and Energy Policy

April 30, 2009

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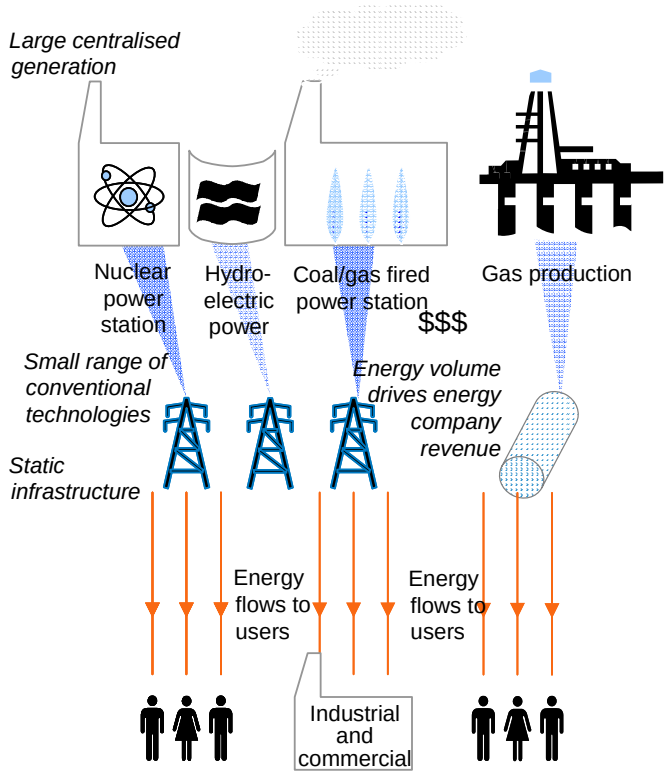
The energy world is changing – utilities playing a critical role in a sustainable future

Traditional energy market



Price and reliability are main determinants of customer choice

Today's evolving market

- Distributed generation
- Energy efficiency
- Infrastructure enhancement
- Smart grid
- Demand management
- Wind sources
- Solar sources
- Clean technology
- Energy storage

Our role is being redefined

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Regulation and Pricing – our strategic priorities…

Optimize cost recovery in rate cases

- Encourage regulators to allow recovery for increasing opex and capex
- Focus on timely recovery of all capital investments
- Minimize the use of deferrals to minimize cashflow impact

Earn a fair return

- Seek returns that reflect market risk of similar investments
- Seek returns that provide proper incentives to attract capital

Pursue Innovative Ratemaking Mechanisms

- Establish National Grid as a national policy leader shaping energy, environmental and regulatory policy
- Seek innovative cost recovery and incentives for EE, solar and smart grid
- Pursue *decoupling* to minimize EE program impacts

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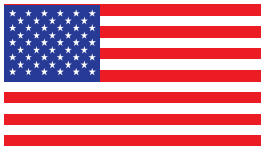
Regulatory relationship in the US is at a new level

- **Demonstrating leadership in shaping regional energy policy**
  - Innovative Solar and Smart Grid demonstration projects proposed
  - Transformational approach to the New York State Energy Plan
  - Design of renewables language for Massachusetts Green Communities Act
- **Positive benefits of storm restoration**
- **Recent positive gas rate cases in NY, RI and NH**
- **Transformational nature of US Energy and Environmental agenda offers increased opportunity to help regulators address pressing challenges**

Regulatory jurisdiction…
…ratemaking methodology



Federal		
	Method	Delivery Revenue
FERC	Formula (Projected)	18%

State		
	Method	Delivery Revenue
New York PSC	Projected	55%
Massachusetts DPU	Historical	19%
Rhode Island PUC	Projected	7%
New Hampshire PUC	Historical	1%

- Rates remain in effect until request for change
- Allowed to recover operating costs plus a return on invested capital base
- Incentive mechanisms can be built into rate plans

National		
	Method	Delivery Revenue
Ofgem	Projected	100%

- Price Controls typically 5 years
- RPI-X price control

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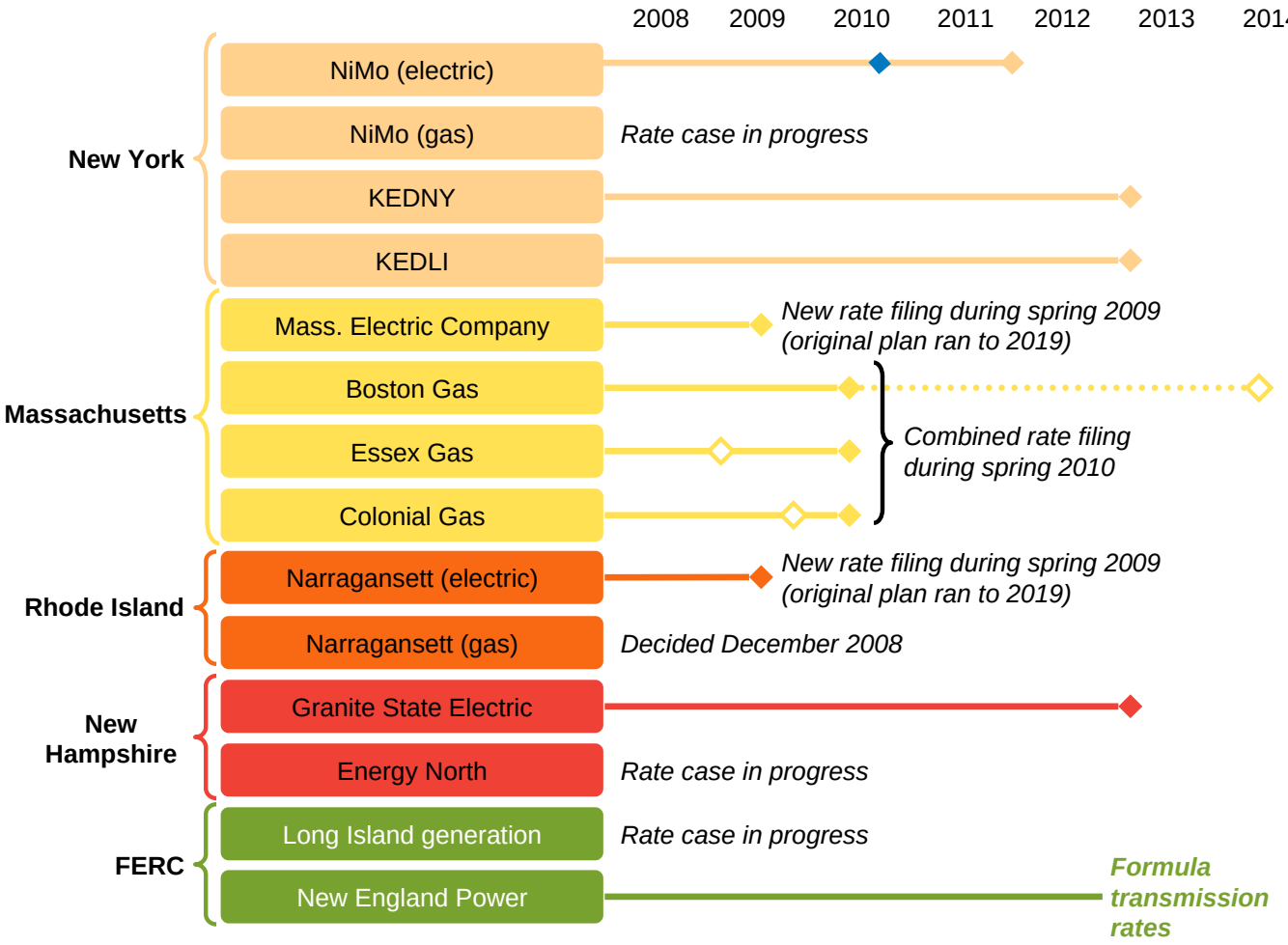
Regulatory Calendar
…updating all our US rate plans



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Future US policy & regulatory framework 2009/10 a big year for the rate case…..

Rate Case	What we are asking for	Increased rates from[1]
Nimo (gas)	Timely recovery of costs Allowed returns at industry average Current recovery of system investments Decoupling Pension true ups OPEB true ups Bad debt recovery Structure to redefine role of utility	20 May 2009
Narragansett (gas)		1 Dec 2008
Energy North		June 2009
Mass Electric Company		1 Jan 2010
Narragansett (electric)		1 Jan 2010
Boston Gas		1 Nov 2010
Essex Gas		1 Nov 2010
Colonial Gas		1 Nov 2010
NIMO (electric)		1 Jan 2011

1 Dates are based on expected commission decision

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Recent Regulatory Decisions

	Rhode Island Gas	Upstate NY Gas Settlement	New Hampshire Gas Settlement
Period:	• 1-year with incremental pipeline replacement programme	• 2-year rate agreement	▪ 1 year ▪ Settlement agreement resolving all issues except ROE (being litigated with NHPUC)
Requested Revenue:	• $18.6 million	• $84.2 million	• Requested ~$10 million in February 2008
Received Revenue:	• $13.7 million	• $39.4 million • Adjustments in 2nd year for pension & OPEB, property taxes and environmental remediation	• Interim rate increase of $6.6 million, in effect August 2008
Rate Increase:	• 10.9%	• 13.7%	• Final to be determined
ROE:	• 10.5%	• 10.2%	• Awaiting decision of NHPUC , which impacts final rate decision.
Earnings Sharing:	• 1st 100 basis points 50/50 customer/shareholder • Above 100 basis points 75/25 sharing	• Up to 11.35% - 100% to shareholders • Next 225 basis points - 50/50 customer/shareholder • Next 200 basis points - 75/25 • Above 15% - 90/10	• To be determined
Bad Debt:	• Increased to 2.46% of revenues	• Increased to 1.75% of revenues	• Commodity portion of bad debts 2.54% for this year and delivery rate assumption of 1.75%
Decoupling:	• Denied, however, fixed portion of customer bills increased. • Weather normalization continues	• Approved	• No, however, fixed portion of customer bills increased.
Annual true-ups:	• Pension and OPEBs • Environmental remediation • Accelerated pipeline replacement programme	▪ New debt interest expense w/ dead band at 6.9% • Pension and OPEBs • Environmental remediation • Accelerated pipeline replacement programme	• Continued environmental reconciliation agreement • Cast/Iron Bare steel replacement program per Merger Agreement

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Next Steps
Upcoming Massachusetts & Rhode Island Electric Rate Filings

- **Updated cost of service after more than ten years**
- **Pension and OPEBs reconciliation**
- **Bad Debt Reconciliation**
  - **Commodity bad debt charge-offs & administrative costs**
  - **Delivery bad debt tracker above or below a collar for charge-offs included in base rates**
- **Storm Fund recovery**
- **Decoupling mechanism proposal to include adjustment for capital spending and inflation net of a productivity offset**

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Pensions & OPEB recovery mechanisms

Each of our five US regulatory commissions regulate the level of costs related to pensions and other post-retirement employee benefits (OPEBs) that are charged to customers.

Approach 1: Periodic reconciliation of revenues to reconcile to actual pension/OPEB costs	
Jurisdiction	**Mechanism**
NY	Reconciliation with deferred amounts collected/ credited in next rate case
MA – Boston Gas	Reconciliation with deferred amounts collected/ credited over 3 years
RI – Gas	Annual reconciliation agreed in recent rate case
FERC – Tx	Formula Rate – monthly reconciliation of actual expenses
LIPA – Gen	Base rates with no true up at FERC but true-up at end of LIPA contract

Approach 2: Pension/ OPEBs as one component of cost of service used to set rates. Level remains in effect until next rate case with no true-up in interim.	
Jurisdiction	**Mechanism**
MA – MECO, Colonial, Essex	Propose reconciliation mechanism in rate case filing in 2009 (MECO) and next gas filings (TBD)
RI - Electric	Propose reconciliation mechanism in rate case filing in 2009
NH	PUC Staff generally oppose reconciliation

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Energy efficiency and renewables/smart grid programmes

Energy efficiency programmes

New York

- 3-year programme targeting over 600,000MWh and 18,000,000 therms through 2011.
- Incentives of $38.85/MWh based on achieved savings;
- Potentially worth ~$24m after tax over 3 year period
- Cost recovery began October 2008

Massachusetts

- State spends $216m per year, our share is ~50%
- Statewide 3-yr programme in development for 2010-2012 (to be submitted 30 April)
- Spending expected to grow to $600m per annum by 2012 and we intend to maintain our share
- Current after-tax incentive of ~$4.9m

Rhode Island

- $29m gas and electric programme approved for 2009 with spending to increase in 2011 to $49 million.
- After-tax incentives of ~ $1.3m in 2009, growing to $2.1m in 2011

New Hampshire

- 2009 programme of $5m gas and electric spending
- Filed joint proposal in March to increase electric spending by about 50% in balance of 2009
- After-tax incentives of approx $0.5m in 2009

Renewable energy/smart grid Investment

New York

- New York State PSC solicited National Grid's renewable energy policy recommendations
- As part of SMART Grid filing solar development is proposed
- Filed two 40,000-customer smart grid demonstration projects with PSC for Federal stimulus funding

Massachusetts

- Allows National Grid to invest up to 50MW rate based solar generation.
- Initial 5MW of solar development – Identified and filed with the Department of Public Utilities – awaiting decision.
- Estimated $31m investment
- Filed proposal to build and operate a smart grid pilot involving 15,000 customers in Massachusetts as required under the State's Green Communities Act

Rhode Island

- Legislation approved allowing utilities to own up to 15MW of solar or wind – Plan in development

New Hampshire

- Legislation allows for up to 5MW distributed resources to be rate based

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US Climate Change, Energy Policy & Economic Stimulus Legislation

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Recent developments – Federal & State

- **Energy related issues are a significant focus for Obama Administration**
  - Re-gaining " high ground" for US globally on Climate Change
  - Comprehensive Energy Policy , embracing Energy security and Climate Change
  - Clear linkage to focus on " Clean tech" economic stimulus
- **Ongoing work on two bills to go to House and Senate by Memorial Day 2009, but these may be combined into a substantial single bill**
- **In addition, developing State level Energy Plans and/or Legislation in all NE states to embrace emerging federal themes and to link to stimulus funding; incl:**
  - Energy Efficiency
  - Smart Grid
  - Meeting Renewable Portfolio Standards

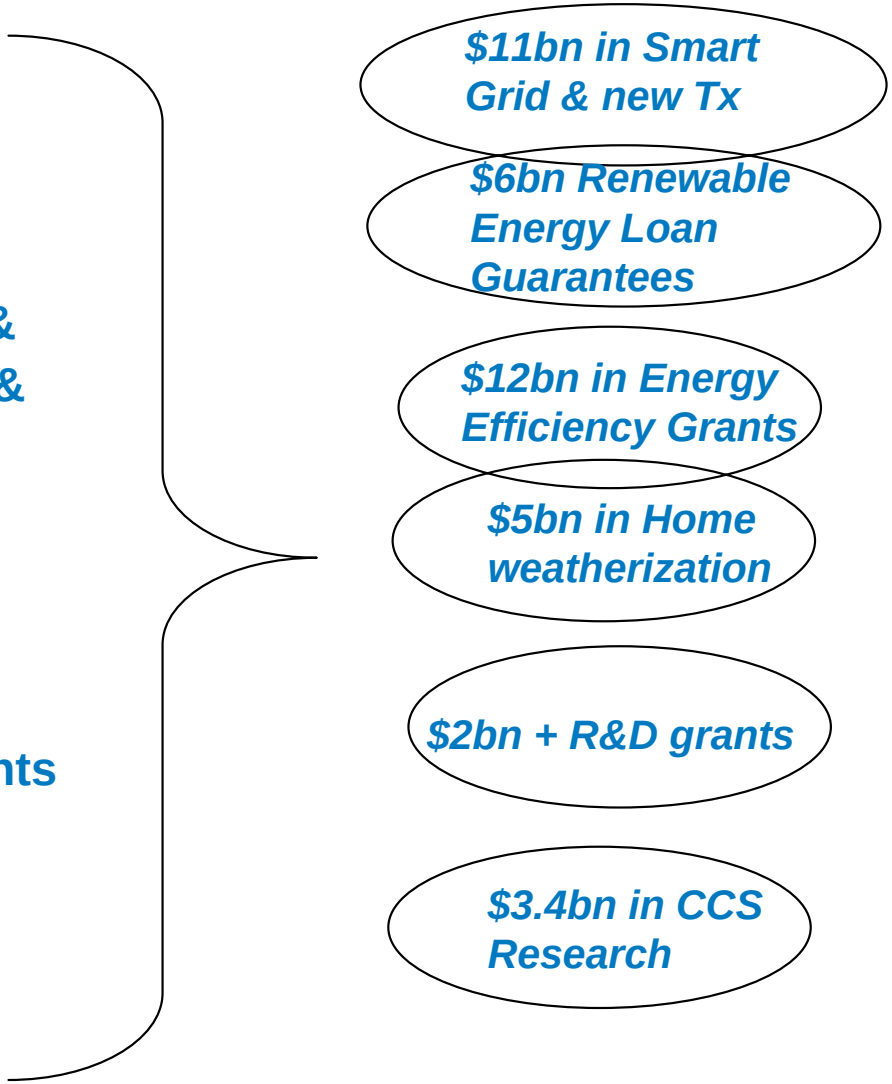
Federal Economic Stimulus Package – early headlines

- **10% of the $787bn Stimulus Bill is targeted at Energy related investments**
  - $83bn in tax incentives & spending linked to " Clean tech" sectors
  - $27.5bn for transport, of which some will go into SMART/Clean transportation
- **Focus on creating new " green" jobs to be realised in next 12-24 months**
- **Funding to be allocated by a combination of Department of Energy (DOE) & through various stage agencies**
  - Appropriations – 60%
  - Tax Incentives – 40%
- **Wide range of possible funding/incentive mechanisms**
  - Incremental funding/grants for new projects
  - Tax incentives
  - Loan Guarantees
  - Additional funding for existing schemes
  - New Innovation /R&D funding

Clear Alignment of Energy Related Stimulus Funding

Opportunities for NG

- **Energy Efficiency (State Energy Programs, Weatherization, Appliances)**
- **Smart Grid (both Transmission & Distribution)/Targeted Research & Development**
  - Energy Storage
  - Renewables
  - Advanced Batteries
  - PHEV's
- **Transportation (Clean Cities Grants for advanced vehicles)**
- **Tax (depreciation, investment credits)**



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Climate Change Legislation - Waxman-Markey Energy Bill

Creating the tie between economic vitality and a cleaner environment

- **Setting of short and long term "enforceable" emissions targets**
  - Setting of National Renewable Portfolio Standard and " cap & trade"
- **Incentive Framework to promote State /Local initiatives to address global warming**
- **Introduction of transparent market based system to address carbon emissions**
- **Focus on re-investment of carbon revenues**
  - "Affordable" Consumer Bills
  - Energy efficiency
  - State & local support
- **Commitment to Global role and US support to developing nations**

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What has been done to date

- **National Grid has provided input to key stakeholders in each of our 4 states & is continuing the dialogue**
  - List of “shovel ready” new projects
  - Suggestions of enhancements to existing customer programs
- **Cross Line of Business team established to co-ordinate National Grid response at Federal, State and Corporate Level**
  - Evaluate potential scale of opportunity
  - Establish priorities to be addressed
- **National Grid seeking to prioritize our participation across many areas to benefit our customers, advance our strategy and optimize return to business**

Proposed National Grid approach:

- **Energy Efficiency (State Energy Programs, Weatherization, Appliances)**

- **Stimulus Funding directed largely via States continue to focus through existing National Grid programs**

- **Smart Grid (both Transmission & Distribution)/Targeted Research & Development**
  - Energy Storage
  - Renewables
  - Advanced Batteries
  - PHEV's

- **Primary focus in terms of scale/scope**
- **Opportunity to capture matching funding**
- **Varied approach by each of our 4 States**

- **Transportation (Clean Cities Grants for advanced vehicles)**

- **National Grid to participate in both DOE transport electrification & Clean Cities alternative vehicle programs with partners**
- **Supporting applications in all 4 States for clean vehicles**

- **Tax (depreciation, investment credits)**

- **Includes direct and indirect benefits to National Grid.**
- **ITC benefit with Solar effort and ITC/PTC benefit in pricing Long Term Contracts**

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Potential Electric Delivery/Energy Reliability Projects in New York (Examples)

- **Smart Grid - ~$240 million (NY only)**
  - Deployment of spine in Syracuse and Albany
  - Mix of modules, including energy storage, solar, microgrid, PHEV
  - Number of meters and mix of modules can be adjusted to reflect available funding

- **Transmission - ~ $25 million**
  - Update electro-mechanical relays
  - Deploy Phaser Measurement Units

- **Distribution - ~ $15 million**
  - SCADA Equipment at substations
  - Distribution Substation Reclosers
  - Updated circuit breakers at five substations
  - Line-based capacitors to support power quality programs

Summary position for just Smart Grid could be…

- **New York - $240 million (NG 50% 120 million)**
- **Massachusetts - $240 million (NG 50% 120 million)**
- **Rhode Island – $80 million (NG 50% 40 million)**
- **New Hampshire - $20 million (NG 50% 10 million)**

Cost estimates include the Smart Grid 'Spine" and "modules" - Solar, PHEV, Energy Storage, Wind, Micro Grids, Micro CHP

Potential stimulus funding sources

- **Matching Fund Grants -** Government funds up to 50% of projects associated with smart grid. Most attractive but needs certainty of suitable cost recovery mechanism for portion funded by customers

- **Bonus Depreciation –** Extension of temporary provision until 31/12/09 allowing 50% tax depreciation in first year. Attractive within calendar constraints.

- **Investment/Production Tax Credits** – Includes direct and indirect benefits to National Grid. ITC benefit with Solar effort and ITC/PTC benefit in pricing Long Term Contracts

- **Loan Guarantees –** Federally guaranteed and thus lower cost debt. Not compatible with our practice of central funding and any benefit of less expensive debt not likely to be retained.

What could stimulus package provide for NG & our customers?

- **The linkages to rate plan regulatory recovery is still at an early stage and we continue to explore this in more detail**
- **Proposed Stimulus financial incentives aim to encourage investment through Investment Tax Credits (ITCs), Bonus Depreciation, Grants, Subsidies, Loan Guarantees**
  - Customers benefit through direct & indirect subsidies from taxpayers
  - Company receives benefits, ***primarily in the form of cash flow up front***
- **To deliver policy objectives, National Grid will need to understand customer bill impact and balance shareholder need**

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