

**TESTIMONY OF THOMAS KING TO THE SENATE STANDING COMMITTEE ON
ENERGY AND TELECOMMUNICATIONS**

October 19, 2010

Mr. Chairman, Senators, I am Thomas King, President of National Grid USA ("National Grid" or "Company"). Thank you for the opportunity to testify about National Grid's accounting and expense practices, our electric rate case pending before the Public Service Commission (PSC), and their effects on customers.

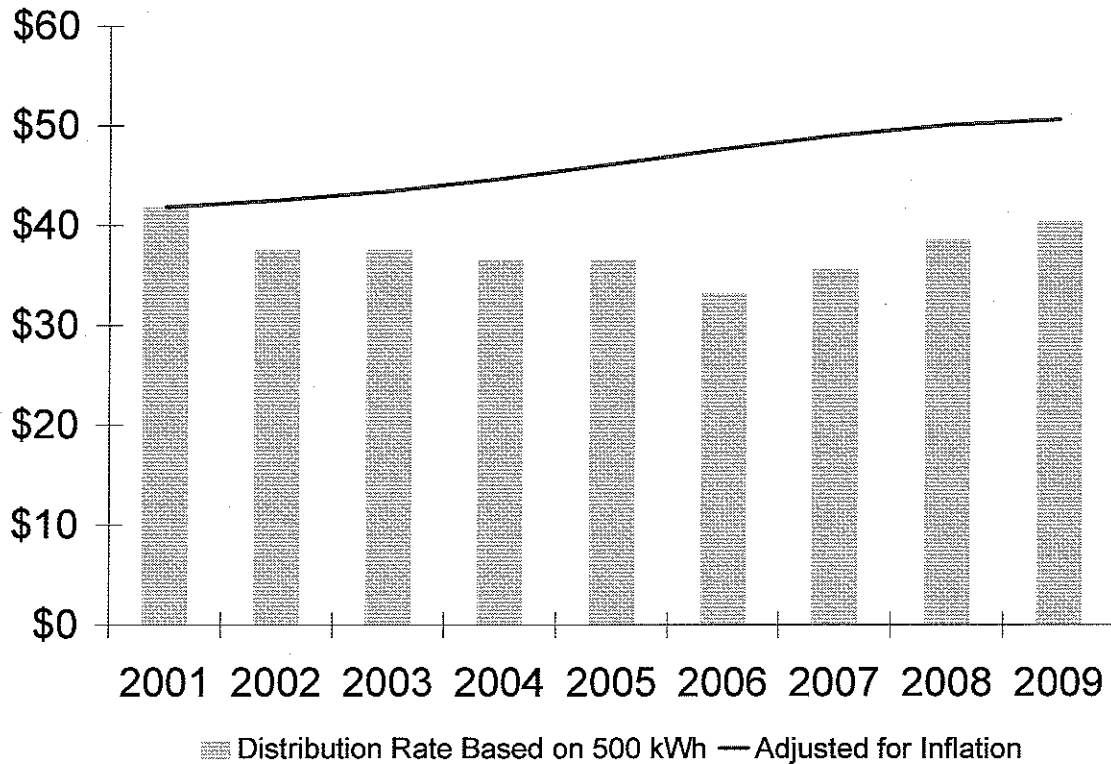
National Grid provides electric and gas service to approximately 3.9 million customers in parts of Upstate, New York City and Long Island. We employ about 12,000 people throughout the state. Each year National Grid pays roughly \$670 million in New York state and local taxes. The Company supports economic development with grants and special rates that are targeted to attract and retain jobs as summarized in Appendix A. The Company is proposing a pilot program in Syracuse in which it would build an intelligent grid to help customers manage their energy costs. This type of innovative investment can help to attract tomorrow's industry to New York. I recognize the important role that we play in the lives of citizens and in the New York economy, and I am mindful of the trust that people place in us to perform that role well.

In January, National Grid filed with the PSC its first Upstate electric rate case in nine years. **Our proposal was structured so that customers as a whole will see no rate increase. Even though our Upstate electric business is not recovering its costs, the Company took pains to file a balanced proposal that took into account the significant financial stress that many customers face as a result of current economic conditions. Rather than simply propose to increase rates to recover the additional revenues the Company needs to recover its costs of providing service, we proposed to forgo the prompt recovery of certain past costs to offset the increase in delivery rates.** Those past costs were scheduled to be recovered in rates by 2011, and we proposed to extend recovery of some of those costs beyond 2011. National Grid initially made this proposal as part of a three-year rate plan that would have generated the revenue the Company needs and maintained electric delivery rates, in the aggregate, at their current levels. The Department of Public Service (DPS) Staff elected to file with the PSC an analysis of our filing that was largely limited to the first year of our three-year proposal. The PSC's decision will therefore set rates for 2011 rather than for three years. Even with a one-year case, National Grid is still proposing to forgo the prompt recovery of some past costs so that customers as a whole will see no rate increase if the PSC approves our filing.

Our current delivery rates are based on a cost study that was filed with the PSC in 2001. The current rate plan began in 2002 with an eight percent rate reduction in delivery rates for customers. It assumed a continuing level of productivity improvements and it credited customers up front with synergy savings that were expected to be achieved from the merger of National Grid and Niagara Mohawk Power Corporation. The rate plan has also credited customers with the anticipated synergy savings from subsequent mergers, including the merger of National Grid and KeySpan Corporation. The rate allowances have not kept pace with inflation or with the cost of meeting incremental regulatory requirements over the intervening years. Nor did the infrastructure investment allowances in the rate plan reflect the necessary investments the Company has made to its electric infrastructure Upstate.

The effect of the rate plan on customers is a good news story. It has provided remarkably stable rates for nine years. In fact, National Grid's current electric delivery rates are lower than they were in 2001, producing significant savings when inflation is taken into account.

Residential Distribution Average Monthly Charge

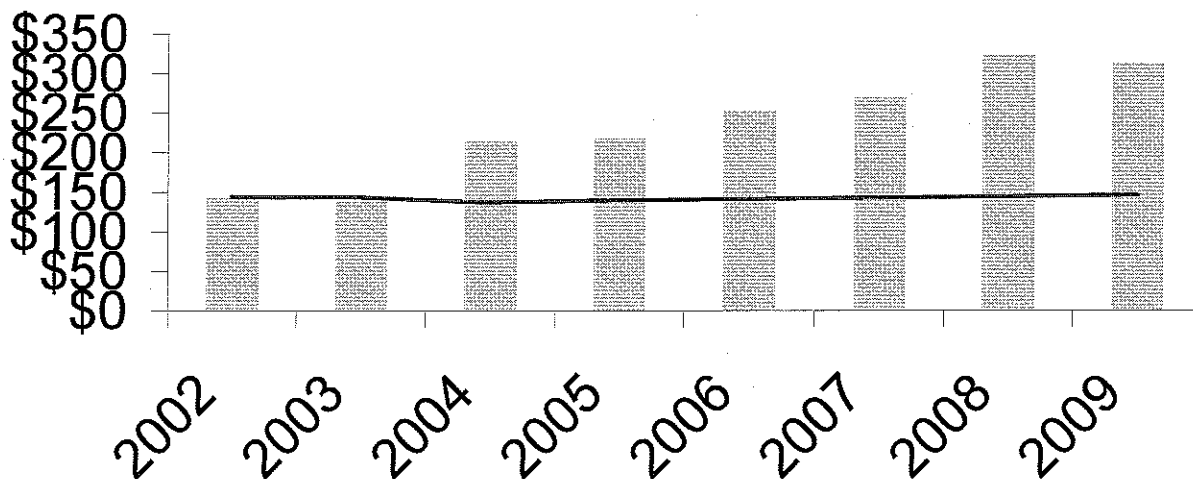


Although our delivery rates have been stable, customers did see an increase in their electric bills last year as a result of the 2009 amendment to Section 18-a of the Public Service Law and increased energy efficiency funding.

Although rates have not been sufficient to compensate National Grid for its cost of providing service, the Company has maintained the safe and reliable operation of the electric system. In order to do so and meet the needs of customers, the Company invested in key infrastructure; replacing aged assets and undertaking necessary upgrades while complying with regulatory and statutory requirements. Since 2004, this has required investments in facilities that exceeded the amounts reflected in rates by approximately \$750 million as shown in the table below. In 2007, National Grid committed to spend at least \$1.47 billion to repair and improve its electric infrastructure by 2011. Since 2008, our infrastructure investment has been over double our rate allowance. Appendix B lists National Grid's significant Upstate infrastructure investment projects since 2007. Included on the list, for example, is a \$1.4 million distribution project to replace substation breakers in Tonawanda and North Tonawanda, a project with which Senator Maziarz may be familiar. The breakers that were replaced were poor performers that had adversely affected service reliability. Another recently completed distribution project located in Senator Valesky's district is the \$1.9 million replacement of switchgear at Springfield

Substation in Dewitt. This replacement project will help to provide reliable service to customers in that area including LeMoyné College. In addition to the safety and reliability benefits that these and other infrastructure investments are providing today, they have injected and continue to inject millions of dollars into the local economy creating good jobs.

Annual T&D Capital Spending (\$ Millions)



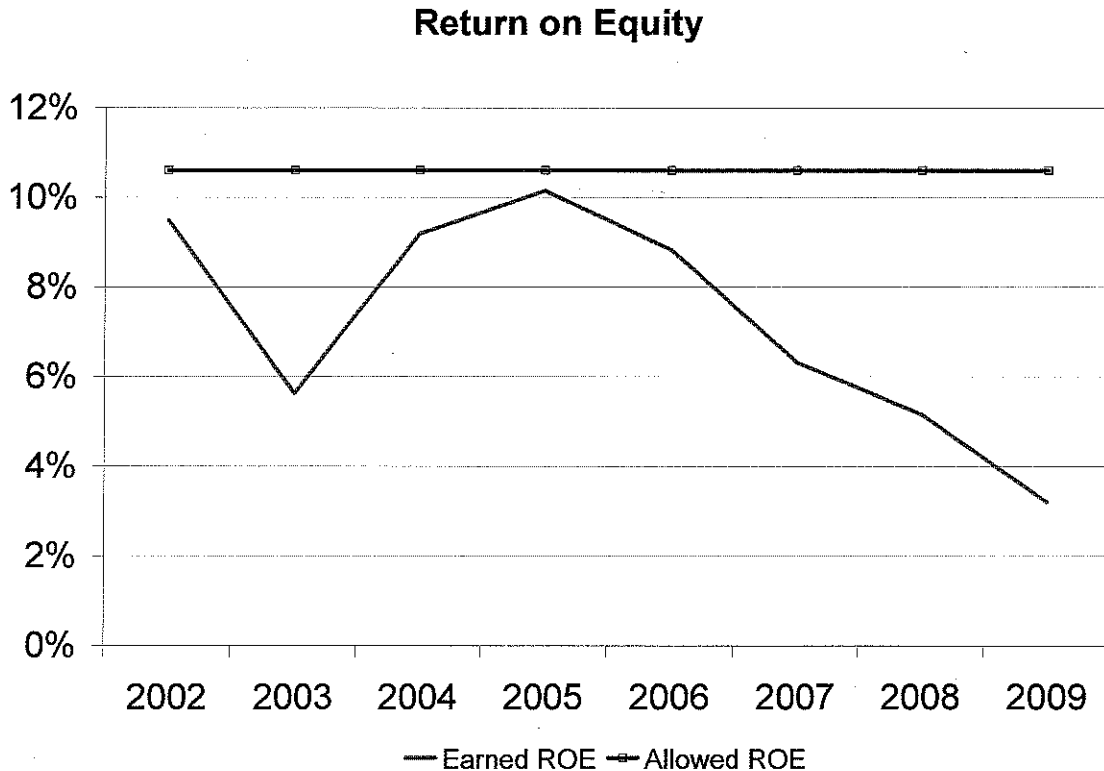
■ Capital Expenditures (Actual) – Rate Plan

The operating and maintenance costs reflected in our current rate plan have also proved inadequate to compensate the Company for the costs of operating and maintaining the electric system. Driven largely by increased costs associated with incremental capital expenditures, as well as new regulatory requirements, operating and maintenance spending has exceeded the allowances in the rate plan since 2004, and the discrepancy has grown larger in recent years.

The PSC sets rates for regulated utilities based on a sales forecast. Traditionally if sales turn out to be less than what was forecast, revenues fall short and the utilities do not recover their costs. Declining sales revenue has aggravated National Grid's financial position. The revenue forecast underlying our current rate plan did not anticipate the recent recession. In 2009, delivery volume was over 1,000 gigaWatt-hours below the projection in the rate plan, which substantially reduced revenues such that National Grid has not been recovering its costs.

The combination of increasing costs, declining sales revenues and a rate plan that does not compensate the Company for the costs of providing safe and reliable service has proven a toxic mix. National Grid earned an equity return of 3.2% in 2009 in its Upstate electric business. As shown in the chart below, National Grid has not earned its allowed return in its Upstate

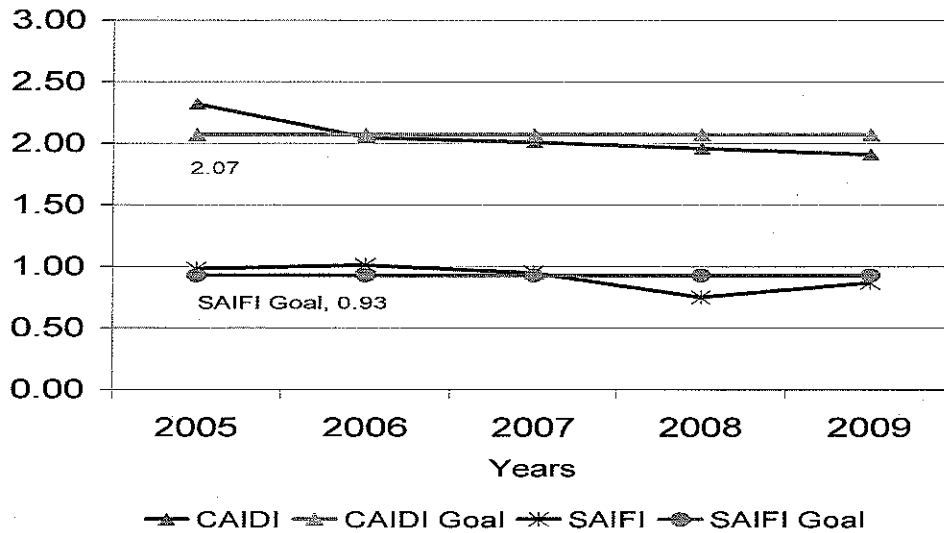
electric business since the inception of the current rate plan, and the actual return on equity has been in precipitous decline since 2005.



Notwithstanding the low equity returns that National Grid has earned from rates under its current rate plan, the Company has funded its Upstate business with its net cash flow. It has used its net cash flow to assure appropriate investment in its infrastructure. However, the Company could no longer maintain the status quo. National Grid could no longer go on operating under the rate plan and continue to provide safe and reliable service to its customers and demonstrate to lenders and investors that it had adequate resources to cover its costs and provide a fair return. These concerns were particularly critical in light of the need to replace the Company's aging infrastructure to ensure reliable performance.

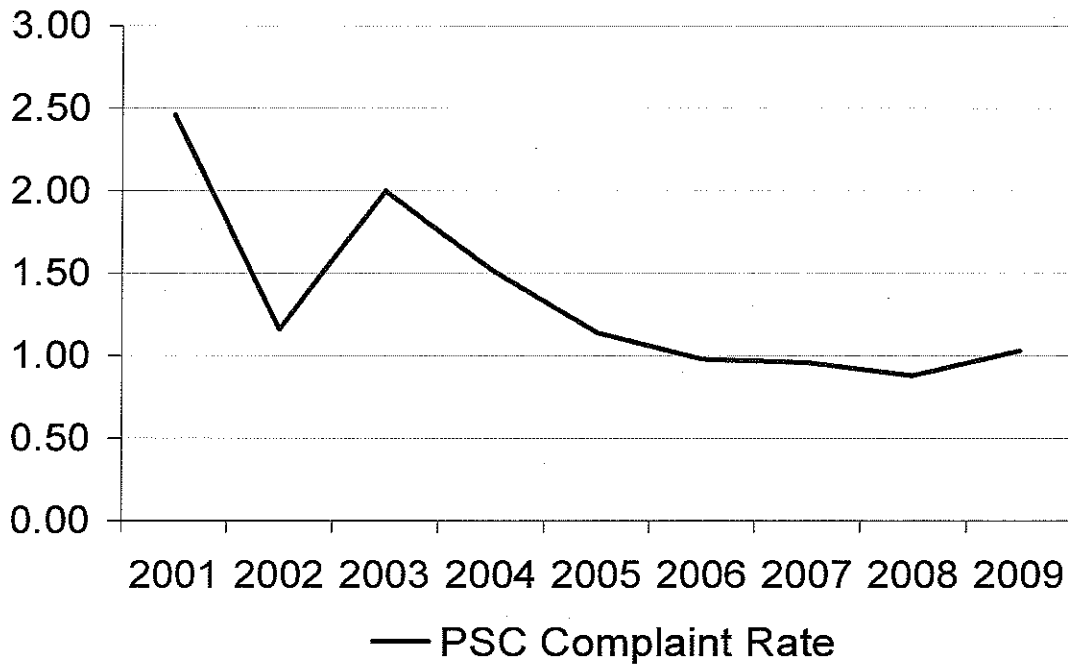
The Company has maintained and even improved on the reliability of its system performance and customer satisfaction notwithstanding the increasing gap between its rates and the costs of operations. National Grid committed to improve its reliability performance at the time of the KeySpan merger and, excluding major storms, the Company has fully satisfied its reliability targets since 2007. The Customer Average Interruption Duration Index (CAIDI) measures how long customers are out of service when they lose power, and the System Average Interruption Frequency Index (SAIFI) measures how many times customers lose power. As the graph below shows, we have reduced both the duration and frequency of power outages experienced by our customers.

Reliability Performance – CAIDI and SAIFI



The Company's customer complaint rate has declined since 2003. We met our customer satisfaction metrics in 2009 and we are on target for meeting them in 2010.

PSC Complaint Rate



The Company has been able to sustain safe, reliable and efficient service to its customers through continuous improvements in productivity and rigorous management of costs. National Grid has taken steps to restrict management compensation and to defer discretionary capital expenditures and filling vacant positions. To facilitate productivity and efficiency improvements, National Grid has implemented a number of programs. Each of these programs has been designed to improve the efficiency and effectiveness of the organization in serving customers and meeting regulatory obligations and each built upon initiatives conceived in the context of the National Grid-KeySpan merger. These transformation efforts have been key to National Grid's meeting the challenges of providing reliable service to customers under its current rate plan. However, in light of increasing costs, reduced cost recovery and effectively capped rates, there is only so much efficiency measures can achieve without compromising core services to customers. National Grid filed its pending rate case to reset its delivery rates because the delivery rates established in 2002 no longer provide the Company with sufficient revenue to cover its costs of providing service, including the costs of infrastructure investments required to provide safe, reliable and efficient service to approximately 1.6 million customers Upstate and a reasonable return on those investments.

I was aware that filing a rate case to increase delivery rates to a compensatory level would be especially difficult in the current financial environment which is placing stress on many customers Upstate. However, struggling through another year of inadequate returns was not a viable option, and would not have been in the best interest of either customers or investors.

National Grid initiated its current rate case by filing with the PSC a detailed accounting of its costs of providing electric service Upstate for the 12 months ending in September 2009. This is the standard procedure for rate cases filed with the PSC. A company's actual costs during a historic year form the basis for forecasting what costs will be in the year for which the company is seeking a rate adjustment.

National Grid's filing with the PSC showed that its actual cost of providing electric delivery service Upstate during the 12 months ended September 2009 was approximately \$1.8 billion. Included within that amount were certain costs that should have been excluded from our rate filing. They were costs associated with some employees that the Company had relocated from the United Kingdom to work in our US business. They also included business expenses for Company officers, directors and other senior management employees. Among the expatriate and senior employee expenses were costs for which customers should not pay. For example, as you may have seen from press reports, National Grid pays private school tuition for the children of expatriates while they are working in the United States. The Company does not expect its customers to pay for those costs. We should have removed them from the historic costs that the Company filed with the PSC for the purpose of setting future rates. We made a mistake. I have apologized publicly for that mistake, and I apologize again today to this Committee.

The DPS Staff, to its credit, identified the inappropriate expatriate and senior employee expense costs that we had included in our rate filing. National Grid reacted by removing expatriate and senior employee expenses from its rate filing. It removed from the rate case approximately \$4.3 million. Included in the \$4.3 million were business expenses that are appropriate for recovery in rates, such as the salaries of expatriates who are working for our Upstate electric business. Nonetheless, rather than try to distinguish between the expatriate and senior employee expenses that are appropriate for recovery in rates and those that are not, we

chose to remove the entire \$4.3 million. These expenses will therefore be borne by our shareholders.

I have also taken action to guard against National Grid making a similar mistake in the future. The Company has engaged The Liberty Consulting Group, a firm that typically works for regulatory commissions, to conduct an independent audit of our financial records and all internal processes and policies implicated by our mistake. I am personally sponsoring this effort. We will make available to the PSC the outcome of this review. The results will assist us in identifying actions that we should take to ensure that we account for all expenses appropriately and that we include in rate filings only those costs that should be included.

The PSC has initiated its own investigation into National Grid's affiliate costs, policies and procedures. We will cooperate with that investigation. In addition, the Federal Energy Regulatory Commission (FERC) is conducting an audit of National Grid's affiliate costs and accounting practices. We have cooperated with and will continue to cooperate with the FERC auditors.

This experience has been a reminder to National Grid and to me personally of an important lesson. Government leaders and our customers trust us to keep the lights on and to restore power when the lights go out. We need to strive for your trust and confidence in everything that we do. I am confident that the review being conducted by Liberty Consulting and the investigations by our regulators will identify the gaps between what actually happened and what should have happened so that we can fix them.

I look forward to the conclusion of our pending rate case before the PSC. Approval of our rate filing would provide the Company with the revenues that it needs to increase its investment in a dynamic and reliable infrastructure capable of attracting tomorrow's industry and bringing the associated employment opportunities to Upstate. We are a major contributor to the Upstate economy and we can do a lot more, but only if we have rates that allow us to recover our costs. A successful resolution to the rate case is important for National Grid, for the Upstate New York economy, and for the customers that we serve.

Thank you for this opportunity to address the Committee.

APPENDIX A

National Grid Economic Development Funding Highlights

- From 2003 through 2009, National Grid has awarded over \$25 million in economic development grants for projects across our Upstate New York territory.
- Our Economic Development efforts have helped generate over \$1.4 billion in new capital investment, while aiding in the creation or retention of over 15,000 jobs.
- National Grid's economic development investments in Upstate have included:
 1. Fifteen (15) Brownfield Redevelopment Assistance projects which have helped advance the redevelopment of contaminated sites and abandoned buildings. Examples include the Spaulding Fibre complex in Erie County and the site of the Syracuse University Center of Excellence in downtown Syracuse.
 2. Forty-seven (47) grants to help offset the cost of energy infrastructure upgrades for expanding industrial customers. Representing over \$7.7 million in total funding, these projects were supported through our Capital Investment Incentive program.
 3. Thus far National Grid has committed \$2,750,000 in grants in support of major urban revitalization efforts in the cities of Niagara Falls, Buffalo, Schenectady and Syracuse. We are currently in discussions with the cities of Albany and Utica to support similar initiatives in those municipalities.
 4. National Grid has awarded over \$3 million in grants through our Main Street Revitalization program, which promotes sustainable economic development by restoring vacant buildings in central business districts to productive commercial use. Since 2003 the program has awarded 81 grants in both large and small municipalities across our Upstate New York service territory.
 5. Working with the leading regional economic development organizations in Upstate New York, National Grid has provided financial and staff support for marketing and sales initiatives aimed at attracting advanced manufacturing companies to the region. Targeted industries include the "CleanTechnology," Life Sciences and Nanotechnology sectors.
 6. National Grid helped fund a feasibility study related to the potential re-starting of the New Falls paper mill in Northern New York. The study played a key role in the eventual re-opening of the mill in 2007 – a project that has created over 100 manufacturing jobs in a rural community that was still suffering from the plant's closure 8 years before. We are now working with Newton Falls Fine Paper to facilitate a large scale renewable energy project that could further boost regional employment while reducing carbon emissions.
 7. National Grid's support was a key driver of both the site development and marketing efforts that ultimately attracted Global Foundries to the Luther Forest Technology Campus in Saratoga County. We are using a similar approach and strategy to advance the development of other high-potential sites, such as the 1,300 acre "Science, Technology and Advanced Manufacturing Park" in Genesee County, Western New York.
- In September 2009, National Grid was named by Site Selection magazine as one of the Top U.S. utilities in economic development.

APPENDIX B

Major Distribution and Transmission Projects Completed Since 2007

Item	Project	NMPC Division	Town/Region	County	Senate Districts and Senators
1	Gardenville – Homer Hill #151 and #152 \$30 million project to refurbish these circuits to address condition issues.	Western	West Seneca to Fredonia	Erie, Chautauqua	57 – Young 58 – Stachowski 59 – Volker
2	Transformer Replacements \$16m for replacement transformers for Packard and New Gardenville substations in Erie county following the failure of sister units at New Gardenville and Dunkirk in Chautauqua county.	Western	Niagara Falls, Dunkirk	Niagara, Chautauqua	57 – Young 58 – Stachowski 59 – Volker 60 – Thompson 61 – Ranzenhofer 62 – Maziarz
3	Lockport – Mortimer #113 and #114 \$13.5 million project to refurbish these circuits to address condition issues	Western	Lockport - Brighton	Niagara, Monroe	62 – Maziarz
4	Renaissance Drive Substation 115kV-13.2kV \$6M project to construct a new 115kV-13.2kV Substation in Amherst NY to address load growth in the area.	Western	Amherst	Erie	61 - Ranzenhofer
5	Southeast Amherst – South Corridor Distribution Reinforcement \$4M project to reinforce the distribution system to address load growth in Amherst NY – Related to Renaissance Drive Substation	Western	Amherst	Erie	61 –Ranzenhofer
6	Buffalo Station 21 Rebuild \$4M project to rebuild a 23kV-4.16kV Substation in Buffalo due to asset condition and safety issues. Substation installed in 1928	Western	Buffalo	Erie	58 – Stachowski 60 – Thompson
7	Cloverbank Substation – New 13.8kV Switchgear	Western	Hamburg	Erie	58 – Stachowski

	\$2.5M project for installation of new 13.8kV switchgear to address capacity issues.							
8	Buffalo Station 33 Rebuild \$2M project to rebuild a 23kV-4.16kV Substation in Buffalo due to asset condition and safety issues. Substation installed in 1928	Western	Buffalo	Erie		58 – Stachowski 60 – Thompson		
9	Station 56 and Station 79 Breaker Replacement \$1.4M project to replace five (5) oil circuit breakers at Station 56 and three (3) oil circuit breakers at Station 79 to address condition and performance.	Western	North Tonawanda/ Tonawanda	Niagara, Erie		60 – Thompson 61 – Ranzenhofer 62 – Maziarz		
10	Clay 345kV station \$36 million project to rebuild Clay substation.	Central	Clay	Onondaga		50 – DeFrancisco		
11	Akwasasne Substation \$3M project to construct a 115kV-34.5kV-4.8kV Substation in the Akwasasne St Regis Area to relieve 34.5kV capacity issues in the Northern area and serve additional 4.8kV load.	Central	Massena	St Lawrence		47 – Griffo 48 – Aubertine		
12	Bombay-Nicholville – 34.5kV Line \$3.5M project for Line Construction to address capacity and contingency issues in the Northern area. Associated with the Akwasasne Substation.	Central	Bombay	Franklin, St Lawrence		45 – Little 47 – Griffo		
13	Hamilton College – 46kV Line \$2.6M project to construct new 46kV lines to supply a new substation at Hamilton College in Clinton NY.	Central	Clinton	Oneida		47 - Griffo		
14	Springfield Substation 34kV-4.8kV Switchgear Replacement \$1.9M project to replace a 4.8kV switchgear to address asset condition issues and reliability. Supplies LeMoynes College.	Central	Dewitt	Onondaga		49 – Valesky		
15	Edic – New Scotland #14 345kV line \$35 million project to replace 139 towers.	Central/ Eastern	Utica to Albany	Various		44 – Farley 46 – Breslin 47 – Griffo 51 – Seward		

16	<p>ATB Circuit Breaker Replacements</p> <p>\$15 million project to replace twenty-six General Electric 34.5kV 'ATB' circuit breakers at Leeds, Volney, Oswego, New Scotland and Edic substations</p>	Central/ Eastern	Various locations	Various	46 – Breslin 47 – Griffio 48 – Aubertine 49 – Valesky
17	<p>Ticonderoga – Republic / Whitehall Refurbishment</p> <p>\$12 million project to address safety issues on the 115kV Ticonderoga – Republic / Whitehall circuits.</p>	Eastern	Glens Falls	Essex Washington	45 – Little
18	<p>Rotterdam-Schoharie #18 69kV Line Rebuild</p> <p>\$11M project to refurbish 69kV line to address reliability issues. Replacement of 166 deteriorated wood pole structures.</p>	Eastern	Rotterdam/ Schoharie	Schenectady, Schoharie	44 – Farely 51 – Seward
19	<p>Battenkill 57 Rebuild Conversion</p> <p>\$1.9M project to rebuild and convert a feeder from 4.8kV to 13.2kV to address voltage and reliability issues. Alleviates voltage issues and provides feeder ties to other circuits in the area.</p>	Eastern	Greenwich	Washington	45 – Little
20	<p>North Troy – Line 19/20 34.5kV Line Refurbishment</p> <p>\$1.6M project to refurbish Line 19/20 34.5kV Line and replace deteriorated structures.</p>	Eastern	North Troy	Rensselaer	43 – McDonald
21	<p>Steel Structure Replacement</p> <p>\$19 million to replace steel transmission structures to address design issues.</p>	Western/ Central/ Eastern	Various locations	Various	Various