Narragansett Electric
A National Grid Company

Terry L. Schwennesen
General Counsel

August 25, 2003

BY HAND DELIVERY AND BY ELECTRONIC MAIL

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

Re: Docket 3400 Pre-Hearing Briefing Issues

Dear Ms. Massaro:

Enclosed behalf of the Narragansett Electric Company ("Narragansett" or "Company") are an original and nine copies of a Pre-Hearing Memorandum submitted by the Company in this proceeding. The Commission has asked to be briefed on the following questions: (1) Whether the Commission has the authority under either state or federal law to order a surcharge to fund the proposed program; (2) Whether the Commission could order a surcharge during a distribution rate freeze period (See Settlements in Docket Nos. 2930 and 3401); and (3) Whether the proposed surcharge would violate any provision of state or federal law.

Thank you for your attention to our filing.

Very truly yours,

Terry L. Schwennesen

Enclosures

c: Docket 3400 Service List

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State of Rhode Island and Providence Plantations

Public Utilities Commission

IN RE: Investigation into the Feasibility of Debt Forgiveness Plan on Energy Bills	R.I.P.U.C. Docket No. 3400

PRE-HEARING MEMORANDUM OF THE NARRAGANSETT ELECTRIC COMPANY

Respectfully submitted this 25th day of August, 2003 by:

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280 Melrose Street
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Briefing Issues

1. **Whether the Commission has the authority under either state or federal law to order a surcharge to fund the proposed program.**

Although there are limitations, the Company believes that the Commission has the authority to order a surcharge in this proceeding. The Commission's grant of authority under state enabling statutes represent "a clear legislative intent to grant the Commission broad powers as it seeks to establish a system of rates that will be just and reasonable to all concerned including the utility and its customers." R.I Chamber of Commerce Federation v. Burke 443 A.2d 1236, 1237 (1982). In addressing the Commission's authority with respect to the above issue, however, it is first necessary to identify and distinguish the three components of the proposal supported by the Consumer Advocacy Groups: (1) a debt forgiveness component, (2) a forward-looking rate subsidy applicable to low income customers and based on a percentage of customer income, and (3) cost recovery of the first two components through a non-bypassable volumetric surcharge on customers' utility bills. Addendum of Advocacy Groups, p.3 (June 19, 2003).

a. Arrearage Forgiveness - With respect to the first component of the proposal, arrearage forgiveness, state enabling statutes have specifically authorized the Commission to approve arrearage forgiveness for low income households eligible for LIHEAP so long as they are structured as part of a percentage of income payment plan (such as the rate subsidy being proposed in the second component) administered by the governor's office of energy assistance. Pursuant to § 39-2-5 (10) of the Rhode Island General Laws:

> (10) Nothing in this section nor any other provision of the general laws shall be construed to prohibit any public utility with the approval of the Commission, from forgiving arrearages of any person in accordance with the terms of a percentage of income payment plan administered by the governor's office of energy assistance for low-income households who are eligible to receive funds under the federal low income home energy assistance program.

Although the intent of this section relates to a prior Percentage of Income Payment Plan or "PIPP" that has since been terminated, the continuing presence of this statute on the books, as well as its generic description appears to authorize the Commission to institute future programs that are consistent with the characteristics outlined within the statute. Furthermore, it could be argued that the present LIHEAP program administered by the State Energy Office already qualifies as a PIPP program without further modification because distribution of grants is, in part, based on income levels.

b. Discounted Rates and Surcharges - The Commission's authority to order the implementation of discounted rates as proposed in the second component, or a surcharge to the rates of all customers as set forth in the third component, is less certain, however. The Rhode Island Supreme Court ("Court") has frequently struck down such proposals as discussed below and has left a legacy significantly narrowing the Commission's authority. A complete answer to this question requires a detailed analysis particularly since the proposal at appears to be unique in that it was proposed by the Low Income Advocacy Groups and was not proposed by either the utilities or the Commission. The following analysis outlines the status of the Rhode Island law on these matters:

i. Utility Initiated Rate Changes - In a utility initiated filing, the burden is on the applicant utility to justify the legal basis for its proposed rate structures. Blackstone Valley Chamber of Commerce v. Public Utilities Commission, 396 A.2d 102 (R.I. 1979). It is incumbent on the utility, as the proponent of the change, to establish that its proposed rate schedules are nondiscriminatory. Town of Narragansett v. Malachowski, 621 A.2d 190, 196 (R.I. 1993). If the utility proposes a rate increase (surcharge), it is the function of the Commission to determine whether the result to be achieved is a fair and reasonable rate "without unjust discrimination, undue preferences or advantages" Id., quoting from §39-1-1(3)(b) of the Rhode Island General Laws. If the utility is proposing discounts for certain classes of customers, any finding by the Commission approving a discount must be supported by "ample evidence" showing that the discounts in questions are "just and reasonable or required in the interests of the public, and not unjustly discriminatory". [1] Violet v. Narragansett Elec. Co., 505 A.2d 1149, 1152, (R.I.

[1] Although § 39-2-5 (2) of the Rhode Island General Laws refers to the powers of the "division" to approve free service or discounted rates to special classes of persons, the court has consistently held that the determination of whether such services or rates are "just and reasonable, or required in the interests of the public, and not unjustly discriminatory" is a matter for the Commission, not the Division, to decide. See e.g. Violet v. Narragansett Elec. Co., 505 A.2d 1149, 1152 (R.I. 1986); Blackstone Valley Chamber of Commerce v. Public Utilities Commission, 396 A.2d 102, 104 (R.I. 1979). In enacting Title 39, the intent of the legislature was to vest the judicial attributes of ratemaking and utility regulation in the Commission and the administrative attributes in the Division. Narragansett Elec. Co. v. Harsch,

1986), quoting from § 39-2-5(2)[2] of the Rhode Island General Laws.

ii. Commission Initiated Rate Changes – In Rhode Island case law, the Court has generally struck down rate discounts established through the Commission's own initiative, thus limiting, but not eliminating the scope of the Commission's authority. In Rhode Island Consumers' Council v. Smith, 302 A.2d 757 (1973) and Blackstone Valley Chamber of Commerce v. Public Utilities Commission, 396 A.2d 102 (1979), the Supreme Court of Rhode Island struck down portions of Commission orders that provided for, on the Commission' own initiative, discounts to the elderly in Smith, and discounts for residential customers in Blackstone. Referring to the Smith case, the court wrote in Blackstone that the Commission was:

> not authorized by § 39-2-2,-3, or -5 to mandate preferential rates to elderly persons. We observed [in Smith that]:
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> While those sections generally prohibit preferential treatment to utility customers, they do, by way of exception, authorize the division to permit a utility to offer 'free or reduced rate service' to an elderly person. But the authority to grant that limited exception does not carry with it the power to compel a utility to afford a reduced rate to senior citizens. Under the statutes the initiative rests with the utility, and the commission cannot, unless so authorized by the Legislature, compel its exercise. (Smith, 302 A.2d at 104).

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368 A.2d 1194, 1199 (R.I. 1977); Providence Gas Co. v. Public Utilities Commission, 352 A.2d 630, 632 (R.I. 1976).

[2] The 1997 Reenactment § 39-2-5 of the R.I.G.L. (P.L. 1997, ch. 326, § 1) re-designated its subsections. Subsection (b) became subsection (2).

The Blackstone court also quoted with approval language from State ex rel. Puget Sound Power & Light Co. v. Department of Public Works, 179 Wash. 461, 468, 38 P.2d 350, 353 (1934), where the Supreme Court of Washington asserted that:

> public service companies are not eleemosynary institutions, and they cannot be compelled to devote their property to a public use except upon the well-recognized basis of a fair and reasonable return therefor. Through general taxation only, in common with all taxpayers, can they be compelled to contribute to the relief of the distressed. Further, in Narragansett Electric Co. v. Harsch, supra at 429, 368 A.2d at 1213, we stated:
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> "We agree with these principles and hold that, in this case, the commission has erred in relying upon the ability of consumers to pay for services in setting [Narragansett Electric's] cost of equity."
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> Only a slight extension of this principle is required to determine that the customers of a public utility engaged in commercial, industrial and nonresidential enterprise are similarly not eleemosynary institutions. These customers cannot be compelled to devote their property in the form of utility payments for the benefit of those deemed worthy by the Commission to be subsidized, particularly in the absence of any specific statutory authority for the commission to mandate such a result. Blackstone Valley Chamber of Commerce v. Public Utilities Commission, 396 A.2d 102, 105 (R.I. 1979).

These strongly worded opinions give rise to several component issues requiring some dissection to understand. First, these opinions cast doubt on the Commission's authority, on its own initiative and in the absence of a utility filed proposal, to design and order discounted rates for certain classes of customers including the resultant increases to other customer

classes. [3] However, what is clear from these cases at the outset is the proposition that the Commission cannot compel a utility "to contribute to the relief of the distressed" out of the pockets of the utility's shareholders. In each of the Smith and Harsch cases cited above, the utilities sought relief from the Court on the grounds that the Commission's actions were confiscatory. Smith at 761; Harsch at 1198. Harsch most clearly enunciated this principle when the Court determined that the Commission is not permitted to penalize utility shareholders by setting a rate of return based on certain customers groups' ability to pay. Narragansett Electric Co. v. Harsch, 368 A.2d 1194, 1213 (R.I. 1977). The present proceeding presently before the Commission can therefore be distinguished from these prior proceedings because the Customers Advocacy Groups propose full compensation to the utilities for their net costs associated with implementing the Plan. Addendum of Advocacy Groups, p. 3 (June 19, 2003)

Second, these opinions raise the issue of whether the Commission can order rate subsidies for certain subsets

[3] If the Commission ultimately determines that a utility initiated filing in this proceeding is necessary before the Commission can squarely address low income issues, the Company would propose not to address the issues in this proceeding, but to propose solutions as part of a comprehensive rate plan that would supercede the Docket No. 2930 rate settlement presently in effect. This would provide Narragansett with the opportunity to address a full spectrum of rate issues including those set forth here. The Company is

of customers and surcharges to others without specific statutory authorization expressing the intent of the Legislature or whether such action would be deemed "taxation" without clear legislative intent. This issue appears to be answered in Rhode Island Chamber of Commerce Federation v. Burke, 443 A. 2d 1236 (R.I. 1982). In Burke, the Rhode Island Chamber and Newport Electric Corporation sought the quashing of actions taken by the Commission to modify a rate plan proposed by Newport by reducing rates to a portion of the residential class using less than 300 kWh per month. In that case, Newport Electric Corporation argued that rate design was solely the province of the utility, basing its argument on Smith and Blackstone *supra*. The court disagreed, stating that Newport:

> [took] nothing by the holdings in [Smith and Blackstone] since the preferential rates imposed by the commission in both instances were not substantiated by cost-related evidence as are the rates in the case at bar. *We have no doubt about the commission's power to formulate a rate design that may differ substantially from that presented by the utility* (emphasis added). . . . [T]he provisions of title 39 were to be construed liberally to aid in the implementation of the declared purposes of title 39 and that the commission was to be endowed with all additional implied and incidental powers 'which may be proper or necessary' in the discharge of its duties. The statutory sentiments to which we have just alluded represent a clear legislative intent to grant the commission broad powers as it seeks to establish a system of rates which will be just and equitable

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presently in discussions with several potential parties as a means toward that end.

> to all concerned including the utility and its customers. Id. at 1237.

Thus, the Commission may certainly formulate a rate design even in the absence of specific legislative intent, particularly if the rates are backed by substantial cost-related evidence. In Violet v. Narragansett Elec. Co., 505 A.2d 1149 (R.I. 1986), the Court found that there was ample evidence to support the Commission's approval of discounted rates for large commercial and industrial customers as a means to pull in new businesses and create new jobs. Id. at 1152. In that case the Court also found that the Commission need not be convinced beyond a reasonable doubt that the plan would succeed, only that it "may" succeed in benefiting Rhode Island's economy. Id. In that proceeding the Court found that the Commission had "ample evidence" to support its conclusion that the price discounts were "just and reasonable, are required in the public interest, and are not unjustly discriminatory" Id., quoting from § 39-2-5 (2) of the Rhode Island General Laws.

In addition, the Court has made clear that the Commission may employ factors other than cost to set rates:

> A restructuring of rates to eliminate or palliate past discrimination … would be among the appropriate objectives toward which the Commission may exercise its power in approving rate design." Smith at 105.

In The Energy Council of Rhode Island v. Public Utilities Commission, 773 A.2d 853, 861 (R.I. 2001), the Court found that rate differentials not based on cost differentials aren't necessarily discriminatory, as long as they are based on different circumstances of customers. See also Town of Narragansett v. Malachowski, 621 A.2d 190 (R.I. 1993) where the Court indicated that:

> in addition to a cost-of-service study, the commission's consideration of other factors such as 'value of service to the community, historical rate design, adequacy of service, environmental considerations, the public benefit and the like, may warrant a departure from or a modification of the rates dictated by cost-of-service'. Id. At 196.

In summary, under § 39-2-5(2), the legislature authorizes the Commission to approve discounted rates, but there appears to be a difference of opinion within the Court as to what constitutes reasonable grounds for deciding when it is appropriate for one group of customers to subsidize another. In reviewing the above described cases, that difference lies in the basis and level of the evidence showing that the proposal is "just and reasonable, or required in the interests of the public, and not unjustly discriminatory". R.I.G.L. § 39-2-5(2).

The final issue, therefore, governing the success or failure of the above cited cases is grounded in the presence of ample evidence or a lack thereof. The Court's role is to determine whether the Commission's decision and order are "lawful and reasonable and whether its findings are fairly and substantially supported by the legal evidence". Rhode Island Consumers' Council v. Smith, 302 A.2d 757, 762 (1973). If a utility proposes discounts for certain classes of customers, any finding by the Commission approving a discount must be supported by "ample evidence" showing that the discounts in questions are "just and reasonable, or required in the interests of the public, and not unjustly discriminatory". Violet v. Narragansett Elec. Co., 505 A.2d 1149, 1152, (R.I. 1986) quoting § 39-2-5 (2) of the Rhode Island General Laws. Similarly, in Smith and Blackstone the Commission failed in initiating discounts to certain customer classes because, "the preferential rates imposed by the commission in both instances were not substantiated by cost-related evidence". Burke at 1237. In Blackstone:

> The determination of the commission to exempt the first 300 KWH used by residential customers, whether elderly, disadvantaged or affluent, cannot be sustained unless based upon competent evidence relevant to the issue of rate design. The result to be achieved is a just and reasonable rate 'without unjust discrimination, undue preferences or advantages'. Blackstone at 105, quoting from § 39-1-1 of the Rhode Island General Laws.

Although the cases of Violet v. Narragansett Elec. Co. and The Energy Council of Rhode Island v. Public Utilities Commission stand for the proposition that the Commission need not always rely on cost-related evidence, it would still need "ample" evidence to show that its decision is "just and reasonable, or required in the interests of the public, and not unjustly discriminatory" pursuant to § 39-2-5(2) of the Rhode Island General Laws.

iii. Third Party Initiated Rate Changes - The case in this proceeding is somewhat unique in that the rate subsidy and surcharge proposal has not been initiated by either the utilities or by the Commission. Rather, it has been initiated by a "third party" in the Customer Advocacy Groups. Under general rules of evidence, the moving party in a proceeding has the burden of proof. As discussed above, regardless of whether the Commission or a utility initiated a proposal, it would only pass muster if supported by ample evidence showing that it is "just and reasonable or required in the interests of the public and not unjustly discriminatory". Violet v. Narragansett Elec. Co., 505 A.2d 1149, 1152 (R.I. 1986). The same should hold true for proceedings initiated by the Advocacy Groups.

2. Whether the Commission could order a surcharge during a distribution rate freeze period (See Settlements in Docket Nos. 2930 and 3401).

The distribution rate freeze settlement approved by the Commission in Docket No. 2930 would not prevent the Commission from ordering a surcharge to rates during the term of the rate freeze period. Indeed, the Third Amended Stipulation and Agreement approved by the Commission in Docket No. 2930 ("Narragansett Settlement")[4], clearly contemplates adjustments to distribution rates during the rate freeze period[5] for certain so-called "exogenous events" beyond Narragansett's direct control. See Narragansett Settlement at Section 6, pp. 8-15. Such events generally include changes to laws or regulations affecting the Company's costs and would include "any state legislative or regulatory mandates which impose new obligations, duties or undertakings" on the Company. Narragansett Settlement, Section 6(B)(1)(iii), p.9.

The Narragansett Settlement also addresses the signatory parties' intent with respect to rate subsidies for low income customers. Specifically, the parties to the Narragansett Settlement agreed that Narragansett's Low Income Rate A-60 would be expanded to include all customers who are eligible for assistance through the state's LIHEAP program. Narragansett Settlement,

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[4] The Narragansett Settlement was approved by the Commission in RIPUC Docket No. 2930, Order No. 16200, on March 24, 2000.
[5] The rate freeze period extends through the end of calendar year 2004. Narragansett Settlement, Section 6.(A), p. 8.

Section 20, p.28. Further, the Narragansett Settlement specifies that the Company will bear the first $600,000 of additional annual costs related to expanding the low income subsidies during the rate freeze period, with all costs in excess of that amount to be recovered from all customers through a fully reconciling uniform per kWh adjustment factor. Id.[6] After the first rate case that establishes rates after the rate freeze period, the Narragansett Settlement also specifies that "the full incremental cost shall be rolled into distribution rates for recovery from all customers." Id. The terms of the Narragansett Settlement thus support a conclusion that any costs incurred as the result of additional subsidies proposed in this docket, in excess of the Company's $600,000 annual contribution during the rate freeze period, would be recoverable from all customers.

3. Whether the proposed surcharge would violate any provisions of state or federal law.

The main concern of this proceeding, whether the Commission has the authority to order a surcharge, was addressed in Section 1 of this Pre-Hearing Memorandum. At this time, Narragansett has no further legal issues of concern with respect to the proposal set forth in this proceeding.

[6] To date Narragansett incurs about $2.2 million in additional costs due to the recent expansion of Rate A-60, of which about $600,000 is paid by Narragansett, while the remainder is recoverable from Narragansett's customers through the rate freeze period. Narragansett anticipates that a total of approximately $3.3 million will have accrued to customers by December 31, 2003