

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
**PUBLIC UTILITIES COMMISSION**

IN RE: NARRAGANSETT ELECTRIC COMPANY :  
PROPOSED STANDARD OFFER RATE : DOCKET NO. 3571

REPORT AND ORDER

I. BACKGROUND

The Utility Restructuring Act of 1996 (“URA”) requires each electric distribution company to arrange with wholesale power suppliers for a standard power supply offer to sell electricity to all customers at a stipulated rate. Pursuant to the URA, Narragansett Electric Company (“Narragansett” or “Company”) entered into wholesale Standard Offer supply contracts with the following prices:<sup>1</sup>

<u>Calendar Year</u>	<u>Price per kWh</u>
2004	5.143 cents
2005	5.543 cents
2006	5.943 cents
2007	6.343 cents
2008	6.743 cents
2009	7.143 cents

The wholesale Standard Offer supply contracts also provide for increases in the price per kilowatt-hour (“kWh”) of wholesale power supplied to Narragansett in the event fuel prices increase above certain levels. To the extent that the total cost of the wholesale power supply to Narragansett, including fuel charges, exceeds retail Standard Offer Service (“SOS”), the under-collection is recoverable from Narragansett’s customers through the annual reconciliation provisions of Narragansett’s Standard Offer Adjustment

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<sup>1</sup> In Docket No. 3496, the Commission approved a Settlement entered into between Narragansett and one of its standard offer suppliers to address responsibility for congestion costs in light of new locational marginal pricing rules in the wholesale electricity market. The settlement altered the base SOS cost in that contract. The chart in this Order reflects the effect of that change when averaged over all SOS contracts. Order No. 17592 (issued October 28, 2003).

Provision. Likewise, to the extent Narragansett collects more than its total cost of providing SOS, the ratepayers are entitled to recoup the benefit, with interest.

## II. NARRAGANSETT

On July 1, 2004, Narragansett filed with the Rhode Island Public Utilities Commission (“Commission”) seeking approval to increase its Standard Offer Rate from 5.9 cents per kWh.<sup>2</sup> The Company proposed nine alternatives. On July 23, 2004, Narragansett filed revisions to the alternatives based on updated fuel projections. Three alternatives were designed to collect the entire projected under-collection by the end of 2004: (1) to increase the Standard Offer Rate to 6.7 cents per kWh effective for consumption on and after August 1, 2004; (2) to increase the Standard Offer Rate to 6.9 cents per kWh effective for consumption on and after September 1, 2004; or (3) to increase the Standard Offer Rate to 7.3 cents per kWh effective for consumption on and after October 1, 2004. Alternatively, the Company proposed three alternatives designed to collect all but \$16 million of the projected under-collection by the end of 2004: (1) to increase the Standard Offer Rate to 6.1 cents per kWh effective for consumption on and after August 1, 2004; (2) to increase the Standard Offer Rate to 6.2 cents per kWh effective for consumption on and after September 1, 2004; or (3) to increase the Standard Offer Rate to 6.4 cents per kWh effective for consumption on and after October 1, 2004. Alternatively, the Company proposed three alternatives designed to collect the entire projected under-collection by the end of 2005: (1) to increase the Standard Offer Rate to 6.58 cents per kWh effective for consumption on and after August 1, 2004; (2) to increase the Standard Offer Rate to 6.63 cents per kWh effective for consumption on and

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<sup>2</sup> On July 16, 2004, The Energy Council of Rhode Island (“TEC-RI”) filed a Petition to Intervene which was not objected to. However, TEC-RI did not participate further in the proceeding.

after September 1, 2004; or (3) to increase the Standard Offer Rate to 6.68 cents per kWh effective for consumption on and after October 1, 2004. The Company's proposed filing would result in an increase between \$1.04 per month and \$7.29 per month or between 1.7% and 12.1% to a typical residential customer using 500kWh per month depending on the alternative approved.<sup>3</sup> In support of the proposed rate increases, Narragansett presented the pre-filed testimony of Jeanne A. Lloyd, Principal Financial Analyst from National Grid USA Service Company, and Michael J. Hager, Vice President, Energy Supply – New England for National Grid USA Service Company.

In his pre-filed testimony, Michael Hager explained that the fuel index adjustments contained in Narragansett's Standard Offer supply contracts are based on Narragansett's forecasted costs under the fuel index adjustment provisions using the future gas and crude oil prices reported in the Wall Street Journal. For his analysis in the instant filing, Mr. Hager used the prices reported in the Wall Street Journal on June 23-25, 2004.

Mr. Hager's analysis showed that Narragansett will pay an arithmetic average fuel index adjustment payment of 1.427 cents per kWh for the Narragansett Zone and 1.699 cents per kWh for the EUA Zone load for the period June 2004 through December 2004.<sup>4</sup> This equates to a total SOS cost under the contracts of 6.527 cents per kWh and 6.800 cents per kWh, respectively.<sup>5</sup> For the period January 2005 through December 2005, his analysis indicated that the Company would pay an arithmetic fuel index adjustment

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<sup>3</sup> Narragansett Ex. 04-1A (Pre-filed testimony of Jeanne A. Lloyd), pp. 8-14, Narragansett Ex. 04-2 (Exhibit JAL-2 Updated), page 3 of 3. The original proposals ranged from a low of 6.3 cents per kWh to a high of 7.5 cents per kWh, or an increase between 3.4% and 13.8% on a typical residential bill. These proposed rates were based on the average natural gas and crude oil prices as reported in the Wall Street Journal on June 23, 2004, June 24, 2004 and June 25, 2004. Narragansett Ex. 04-1A, pp. 8-14; Narragansett Ex. 04-1B (Pre-filed testimony of Michael Hager), p. 5.

<sup>4</sup> Narragansett Ex. 04-1B, Prefiled testimony of Michael Hager, pp. 5-6.

payment of 1.520 cents per kWh for the Narragansett Zone load. The SOS contract fuel payments in the EUA Zone end on December 31, 2004. This equates to a total SOS charge of 7.020 cents per kWh in the Narragansett Zone and 5.500 cents per kWh in the EUA Zone.<sup>6</sup>

Mr. Hager noted that the natural gas and oil prices used in the analysis had declined from those used during the previous month.<sup>7</sup> In Narragansett's July 23, 2004 filing, Mr. Hager provided updated schedules showing the determination of the fuel adjustment value based on oil and gas price estimates as reported in the Wall Street Journal during the three-day period July 20-22, 2004. The result was a slightly lower projected fuel adjustment payment through the end of 2004, in the revised filing described above.<sup>8</sup>

In her pre-filed Testimony, Ms. Lloyd explained that the current SOS rate was designed to collect the base SOS charge for 2004 plus a fuel adjustment of 0.8 cents per kWh. She indicated that, using Mr. Hager's projections, the estimated under-collection as of December 2004 will be approximately \$28 million.<sup>9</sup> In Narragansett's July 23, 2004 filing, Ms. Lloyd provided updated schedules showing that the estimated under-collection as of December 2004 will be approximately \$24 million.<sup>10</sup>

In her testimony, Ms. Lloyd explained that the total SOS charge is based on the addition of the base contract charge plus the estimated fuel index payment on a per kWh basis through the end of the chosen reconciliation period.<sup>11</sup> The calculation of the

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<sup>5</sup> Id. at 5.

<sup>6</sup> Id. at 5-6.

<sup>7</sup> Id. at 7.

<sup>8</sup> Narragansett Exhibit 04-2 (Exhibit MJH-2 Updated; MJH-3 Updated; MJH 4 Updated).

<sup>9</sup> Narragansett Ex. 04-1A, pp. 4-5.

<sup>10</sup> Narragansett Ex. 04-2 (Exhibit JAL-2 Updated, page 2 of 3).

<sup>11</sup> Narragansett Ex. 04-1A, pp. 7-9.

appropriate rate begins with an estimate of the entire under-collection through the end of the reconciling period at the current rate. Ms. Lloyd then estimates the total SOS kWhs to be sold during the same period, estimates the fuel adjustment costs for the period (the under-collection divided by the SOS kWhs for the period), adds that result to the current tariffed SOS rate and the sum is the new rate.<sup>12</sup>

She indicated that Narragansett's preferred alternative was to implement the rate change for usage on and after October 1, 2004 that would collect the total SOS expenses over a fifteen month period. She noted that the intent of keeping the rate in effect through December 31, 2005 would provide some rate stability to customers on the energy portion of the bill over a longer period of time than the other alternatives and would be implemented in conjunction with a distribution rate decrease if the Commission were to approve a Settlement in another docket for effect on October 1, 2004.<sup>13</sup> However despite this preference, Ms. Lloyd noted that the Company shares the Commission's goal of avoiding the accumulation of significant deferrals and that any of the proposed alternatives would further that goal.<sup>14</sup>

In Narragansett's July 23, 2004 filing, the cover letter indicated that the Company proposed to adopt an effective date of August 1, 2004.<sup>15</sup>

### III. DIVISION

In response, on July 16, 2004, the Division of Public Utilities and Carriers ("Division") submitted a Memorandum drafted by David R. Stearns, a Rate Analyst V for the Division. After summarizing the alternatives presented in Narragansett's filing, the

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<sup>12</sup> Narragansett Ex. 04-1A, Exhibit JAL-2.

<sup>13</sup> Id. at 9-10.

<sup>14</sup> Id. at 9, 12.

<sup>15</sup> Exhibit 04-2 (Filing Letter).

Division recommended that the SOS rate adjustment be designed to collect the entire under-collection, that it become effective for usage on and after August 1, 2004, and that it be designed to collect the under-collection over a period of seventeen months, or through December 31, 2005. Mr. Stearns noted that an October 1, 2004 effective date would cause a larger increase. He also noted that there is no guarantee the Commission would issue a decision in the distribution rate dockets by October 1, 2004 and therefore, it may be more prudent to adjust the SOS rate earlier.<sup>16</sup>

#### IV. HEARING

A public hearing was held at the Commission's offices, 89 Jefferson Boulevard, Warwick, Rhode Island, on May 28, 2003. The following appearances were entered:

FOR NARRAGANSETT:	Thomas G. Robinson, Esq.
FOR DIVISON:	Paul J. Roberti, Esq. Assistant Attorney General
FOR COMMISSION:	Cynthia G. Wilson, Esq. Senior Legal Counsel

At the hearing, Mr. Hager and Ms. Lloyd testified on behalf of Narragansett in support of the requested rate change. Mr. Hager testified that the most recent market prices to which the Company can compare the SOS rate are the last resort service rates that had resulted from the July 2004 procurement. Mr. Hager indicated that the procurement costs for residential customers in Rhode Island for the six-month period September 2004 through February 2005 averaged 7.5 cents per kWh while the non-residential load for the same period averaged approximately 7.3 cents per kWh.<sup>17</sup>

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<sup>16</sup> Division Ex. 1 (Memorandum to Commission from David R. Stearns), pp. 1-2.

<sup>17</sup> Tr. 7/26/04, p. 10. Mr. Hager indicated that comments from suppliers indicated that up to .4 cents on the non-residential price is a risk premium to take into account that a last resort service customer is not

Ms. Lloyd testified that the Company's proposal to design the rate to collect the under-collection by December 31, 2005 would allow the energy portion of the bill to remain unchanged for that period "assuming that fuel prices don't change significantly from what [the] most recent estimate has been."<sup>18</sup> Mr. Hager testified that "there has been quite a bit of movement" in the prices of oil and gas between January 28, 2004 and July 22, 2004. He further indicated that "based on past experience, it's difficult to believe that these prices will remain where they are over the 18-month period of time."<sup>19</sup> However, Ms. Lloyd maintained that it is reasonable to attempt a stable rate because eliminating the under-collection by December 31, 2004 would only increase the rate by 0.1 cent. Additionally, she noted that the SOS rate could be reviewed during Narragansett's annual reconciliation of the transmission and transition charges.<sup>20</sup>

Mr. Hager conceded that the trend in oil and gas prices is upward over time. He noted that the fuel adjustment provisions, crafted in 1996 and 1997 took into account the historical prices of oil and gas. Whereas gas prices averaged \$2.50 per MMBtu, with a \$3.00 price being a cause for concern, now prices average \$5.50, with spikes up to \$9.00 and \$10.00.<sup>21</sup> Ms. Lloyd agreed that approximately 21.8% of the new proposed SOS rate would be due to fuel costs.<sup>22</sup>

Mr. Hager stated that it is the Company's position that "the fuel trigger payments will cease to be made to suppliers of the old EUA standard offer load but will continue

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required to commit to a term in order to take that service. The risk premium for residential customers is lower. Id. at 12-13.

<sup>18</sup> Id. at 14.

<sup>19</sup> Id. at 15-16.

<sup>20</sup> Id.

<sup>21</sup> Id. at 52.

<sup>22</sup> Id. at 20.

for the old Narragansett load.”<sup>23</sup> Mr. Hager agreed that Narragansett had shown the distinction between the contracts in the former Narragansett and EUA zones since the testimony filed in November 2002. Additionally, the distinctions had been discussed in a prior Commission order and Mr. Hager stated that he agreed with the Commission’s characterization of the fuel adjustment clauses in the SOS contracts.<sup>24</sup> To date, Mr. Hager had not received communication from three of the four SOS suppliers in the former EUA zone regarding the provision, despite the fact that Narragansett has “mentioned” the provision to each of them. Mr. Hager indicated that one contract has been clarified because it contains the fuel adjustment provision in the contract making a dispute a “non-issue.” This contract makes up approximately 30% of the EUA load.<sup>25</sup>

He reiterated that:

The language in the former [EUA] contracts and the tariff that they refer to, which is no longer in existence, it was very clear that fuel trigger payments only went through '04. For 30 percent of the load we’ve got contractual provisions that do make it clear that it ends in '04 and we do have discussions with that supplier and an acknowledgement that they understand it ends in 2004. For the others, as I said, we’ve had discussions. We’ve indicated our position. We’ve had no objections to the point that there’s disagreement on what the terms are.<sup>26</sup>

However, Mr. Hager also noted that there has been no affirmative agreement from three of the four suppliers.<sup>27</sup>

Addressing the low income rate, in response to a question from the Bench, neither Narragansett nor the Division believed that it would be appropriate to implement a rate change for all but one class of customers. The Company noted that the energy component of the bill is contractual and not subject to the distribution discount currently

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<sup>23</sup> Id. at 21.

<sup>24</sup> Id. at 22-24.

<sup>25</sup> Id. at 25-26.

<sup>26</sup> Id. at 31.

provided to low income customers on the A-60 rate. The Division indicated that delaying the rate change for one class of customers would result in adding to an under-collection the rate is designed to eliminate.<sup>28</sup>

Mr. Henry Shelton appeared on behalf of the George Wiley Center and the Campaign to Eliminate Childhood Poverty to request, through public comment, that the Commission exempt those Narragansett customers who fall within the protected class status of the Commission Rules and Regulations Regarding the Termination of Gas, Electric and Water Service from any increase. Mr. Shelton also supported deferral of the increase to October 1, 2004 for all customers.<sup>29</sup>

#### V. COMMISSION FINDINGS

At its open meeting on July 26, 2004, a majority of the Commission accepted alternative one in Narragansett's revised filing to set the SOS rate at 6.7 cents per kWh effective for consumption on and after August 1, 2004. This rate is designed to recover the under-collection by December 31, 2004. The majority of the Commission opined that fuel prices will most likely escalate over the period rather than decline. Therefore, the expectation of the Commission was that a rate increase would most likely be necessary prior to December 31, 2005 if the proposal to recover the under-collection over a seventeen month period was approved. The effect of the Commission's decision is an increase of the SOS charge from 5.9 cents per kWh to 6.7 cents per kWh. The effect on the typical residential customer using 500 kWh per month will be an overall monthly bill

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<sup>27</sup> Id. at 31.

<sup>28</sup> Id. at 46-48.

<sup>29</sup> Id. at 64. Mr. Shelton also addressed concerns he had with the Commission's current Termination of Service Rules. Id. at 64-67.

increase of \$4.17, or 6.9%. The Commission noted that this decision is consistent with past Commission practice to adjust rates to avoid accrual of large under-collections.

The necessity of this increase is due to the increases in the cost of wholesale oil and natural gas. As part of Narragansett's SOS agreements with suppliers, when the fuel charges increase above a certain level, Narragansett must pay the suppliers an additional amount in addition to the base contract price for SOS, which, for 2004 is 5.143 cents per kWh. The Commission notes that while the market rates may be higher or lower than the SOS rate in some months, the average price for LRS over the six month period September 1 2004 through February 28, 2005 is higher than the current SOS rate, even with the additional fuel costs.<sup>30</sup>

The Commission notes that a market is inherently unstable and, arguably, a truly competitive market should track that instability. Unfortunately, at this point in time, choice in the electricity market does not exist for residential customers. Therefore, in each request for an increase relative to wholesale fuel prices, the Commission attempts to balance the legal requirement of the increase against a desire for stability.

The Commission has also established a policy of not allowing a large under-collection to accrue in the SOS account. History shows that during periods of quickly increasing rates, the Commission has implemented steady rate increases in order to avoid

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<sup>30</sup> The price signal is directed more to non-residential customers and suppliers than to residential customers currently. The Commission notes that Mr. Hager indicated that the procurement costs for non-residential Last Resort Service customers averaged 7.3 cents per kWh over the six month period September 1, 2004 through February 28, 2004. The non-residential last resort service tariff rates for the period August 1, 2004 through December 31, 2004 are as follows: August 2004 – 7.489 cents per kWh; September 2004 – 6.665 cents per kWh; October 2004 – 6.432 cents per kWh; November 2004 – 6.565 cents per kWh; December 2004 – 7.141 cents per kWh; January 2005 – 8.179 cents per kWh; and February 2005 – 8.117 cents per kWh. Although residential last resort service customers pay the SOS rate due to a prior finding by the Commission that no competitive market exists for those customers, the Company must still procure power for them at market rates. The Company is entitled to recover these costs, something which is accomplished during the annual reconciliation rate filing. The procurement costs for the residential Last Resort Service

a large under-collection that could lead to rate shock. During 2000-2001, in order to avoid accrual of significant under-collections due to rising oil and natural gas prices, the Commission approved five rate increases over the course of ten months. The base SOS rate was 3.8 cents per kWh in 2000 and 4.1 cents per kWh in 2001.<sup>31</sup> If the Commission were to deny a rate increase until Narragansett's annual reconciliation filing, Narragansett is projecting an under-collection of slightly more than \$24 million as of December 31, 2004. This new rate is designed to collect Narragansett's costs of providing SOS to customers through the end of 2004 with no significant over or under-collection.

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customers average 7.4 cents per kWh over the six month period September 1, 2004 through February 28, 2004.

<sup>31</sup> The following shows the history of SOS increases and decreases since January 2000. Although meant to be a relatively stabilized transition rate between a fully regulated industry and a competitive market, the SOS rate is impacted by the competitive wholesale fuel market. The list shows how the wholesale oil and natural gas prices affect the standard offer service rate. During periods of unusual price increases and volatility, the prices reflect that aspect of the market. During periods of relative market stability, retail prices reflect that aspect of the market.

January 2000	3.8 cents per kWh
July 1, 2000	4.1 cents per kWh (designed to be in effect through 2000 and to allow a small under-collection by December 31, 2000).
September 1, 2000	4.5 cents per kWh (under-collection growing so rapidly, PUC required Narragansett to file for effect 10/1 in order to eliminate the under-collection that had accrued when retail prices were below cost).
October 1, 2000	5.401 cents per kWh (designed to cover costs of SOS through March 2001 plus an additional Standard Offer Adjustment Factor (SOAF) to cover an already-accumulated under-collection).
January 1, 2001	5.905 cents per kWh (designed to cover costs of SOS through the end of 2001 plus continuation of the additional SOAF to cover an already-accumulated under-collection).
April 1, 2001	6.3 cents per kWh (designed to cover costs of SOS through the end of 2001 plus continuation of the additional SOAF to cover an already-accumulated under-collection).
October 1, 2001	5.5 cents per kWh (designed to leave an over-collection of \$1.6 million plus elimination of the SOAF).
January 1, 2002	4.662 cents per kWh (designed to over-collect for purposes of hopefully providing a three-year rate).
January 1, 2003	No change – utilize the \$20 million payment for fuel index adjustment provision to cover the fuel trigger payments through the end of 2003.
June 1, 2003	5.5 cents per kWh (designed to be in effect through December 31, 2003).
January 1, 2004	5.9 cents per kWh (designed to recover Narragansett's SO costs through December 31, 2004).

The Commission notes that the General Assembly has voted in favor of electric restructuring based on the theory that competition will ensure lower energy prices. What the Commission has seen, however, is that the wholesale market prices have increased dramatically over the past several years. Testimony at Commission hearings has consistently indicated that few, if any experts contemplated that wholesale natural gas prices would settle out at \$5 and \$6 per MMBTU, when they hovered around \$2 and \$3 in 1996. In fact, in the instant case, Mr. Hager noted that \$5.50 per MMBTU seems to be the average, with spikes to \$9.00 or \$10.00 not surprising, whereas spikes to \$3.00 used to surprise observers. The Commission reminds ratepayers that it has no control over these commodity prices.

The Commission notes that Narragansett does not earn any profit on the SOS charge. This portion of the rate is the result of charges that Narragansett must pay in order to distribute the electricity to homes and businesses. With regard to the SOS rate, the Commission regulates Narragansett, but does not regulate the wholesale oil and natural gas prices.

The majority notes that at the open meeting, the dissenting commissioner did not object to a rate change, but rather, expressed a different preference regarding the period of time over which the under-collection should be recovered, noting that extending the period of recovery would allow for a slightly lower increase and further the policy of providing rate stability through moderation in increases.<sup>32</sup> The majority recognizes that the Commission has extended the period of recovery in the past in both the electric and

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<sup>32</sup> The difference between the two positions is 1.0% on the total bill, or 63 cents per month. However, the dissenting commissioner noted that the difference in cost was not the deciding factor, but rather, it was the belief that the extended repayment period would provide some relief especially to those ratepayers on a fixed income.

gas industries. The dissent made a valid argument that raising rates in August increases the burden on ratepayers that an extended recovery period may mitigate and is consistent with the policy behind providing rate stability when possible. However, the majority believes that the additional 1% increase is not significant and will reduce the need for an increase in four months. During the open meeting, the majority believed, based on testimony by Mr. Hager, that wholesale oil and gas prices are going to continue to rise, causing the need for further increases in only a few short months. Therefore, when balancing the Commission's policies of providing rate stability against avoiding large under-collections, the majority finds that the scales tip in favor of reducing, and hopefully eliminating the under-collection by December 31, 2004.

Narragansett shall continue to report monthly on the projected balance of the SOS account as of December 31, 2004. Because of the fact that Narragansett's annual reconciliation filing is scheduled to be made in mid-November 2004, only three and a half months after the effective date of these rates, the Commission will not utilize the \$16 million benchmark for an over- or under-collection for analyzing the need for a rate adjustment. Instead, the Commission will revisit this issue in the annual reconciliation filing for 2005 rates.

Accordingly, it is hereby

(17972) ORDERED:

1. Narragansett Electric Company's proposed retail Standard Offer Service Rate of 6.7 cents per kWh is approved to become effective for service on and after August 1, 2004.
2. Narragansett Electric shall file monthly reconciliations of the SOS account.

3. Narragansett Electric Company shall comply with all other findings and instructions as contained in this Report and Order.

EFFECTIVE AT WARWICK, RHODE ISLAND PURSUANT TO AN OPEN MEETING DECISION ON JULY 26, 2004. WRITTEN ORDER ISSUED AUGUST 26, 2004.

PUBLIC UTILITIES COMMISSION

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Elia Germani, Chairman

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\*Kate F. Racine, Commissioner

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Robert B. Holbrook, Commissioner

\* Commissioner Racine dissents from the majority on the basis that an extended period over which to recover the under-collection would result in a lower rate, thus mitigating the impact on the ratepayers.