Memorandum

To: L. Massaro

Commission Clerk

From: D. R. Stearns, Rate Analyst, DPUC
Stephen Scialabba, Chief Accountant, DPUC

Date: 4/25/2006

Re: Narragansett Standard Offer Filing: Docket 3739

On March 31, 2006 the Narragansett Electric Company d/b/a National Grid ("Narragansett", or "Company") submitted to the Commission a Standard Offer Rate Adjustment Filing ("Filing").

According to projections by the Company based on the then recent fuel price forecasts, maintaining the current standard offer rate of $0.10 per kWh would result in an over collection of $31.9 million at the end of December 2006. In explaining the projected over recovery, National Grid cited lower-than-previously-projected fuel costs resulting from the relatively mild winter. The Company went on to caution , however, that fuel prices remain volatile, and stated they will continue to monitor fuel price trends, reporting monthly to the Commission.

To mitigate the projected over recovery, National Grid proposed a reduction in the standard offer rate from the current $0.10 per kWh to $0.094 per kWh. The Company proposed that the standard offer rate reduction become effective May 1, 2006.

On April 21, Narragansett filed an update which reflected the increase in fuel prices which has occurred since the March 31 filing. Based on the update, the projected overrecovrey has been reduced from the previous estimate of $31.9 million to a revised $14.6 million. Narragansett has revised its standard offer rate proposed for May 1 to $0.097 per kWh. If approved, based on current futures prices for oil and natural gas, there would be an approximate $300,000 overrecovery as of December 31, 2006.

The Division has performed some calculations in an attempt to determine the longer-range effects on rate stability of decreasing the standard offer rate to 9.7 cents per kWh. Rate stability has been a stated goal of the Commission. The Division has also advocated for pricing decisions that lead to more stable rates, especially when dealing with the residential and smaller commercial classes of customers.

First, using the Company's model, we ran a scenario on the assumption that the rate is reduced to \$0.097 effective May 1, 2006 to determine where the rate would have to be set in January 2007 to avoid large deferrals in 2007. To project a \$-0- balance at 12/31/07, the rate would have to go from \$0.097 to \$0.11, effective 1/1/07. To accomplish the same goal in two steps, the rate would go from \$0.097 to \$0.107 on 1/1/07, then to \$0.112 on 7/1/07.

We also modeled maintaining the rate at \$0.10 through 2006. To have a \$-0- balance at 12/31/07, a 12 month rate of \$0.107 would be required at 1/1/07. A two step phase in would require a rate of \$0.103 on 1/1/07 and \$0.111 on 7/1/07. Both these scenarios are based on the recent fuel price projections for oil and natural gas included with the Company's April 21 update. The scenarios are summarized below:

Assumption 1:

<u>Reduce Rate to \$0.097 for May through December 2006:</u>

12-month rate 2007 = \$0.11 effective 1/1/07

Step Rates 2007
Step 1 January through June = \$0.107 / kWh
Step 2 July through December = \$0.112 / kWh

Assumption 2:

<u>Retain Rate of \$0.10 through December 2006:</u>

12 month rate 2007 = \$0.107 effective 1/1/07

Step Rates 2007:
Step 1 January through June = \$0.103 / kWh
Step 2 July through December = \$0.111 / kWh

As stated, these scenarios are based on current futures prices for oil and gas. Reducing the rate to \$0.097 and keeping that rate in effect for an extended period would result in an underrecovery of \$34 million as of 6/30/07.

As mentioned, fuel markets have been volatile and prices have increased between the March 31 and April 21 standard offer filings. Comparing the "gas index" in each filing for the period May 2006 through December 2006 shows an increase in the average gas price for the period from \$8.27 to \$9.21, an increase of 11.4%. Comparing the January 2007 through December 2007 average "gas index" between the filings shows an increase from \$9.68 to \$ 10.59, an increase of 9.4% Oil similarly has increased between the time of the two filings.

Based on the above analyses, assuming the current fuel prices remain at the levels in the April 21 filing, the pricing scenario which maintains the $0.10 price is most in keeping with a policy of price stability for customers. While we say this we are also cognizant of the fact that a number of constituencies have asked for the electric rates to be reduced, and we are aware that the current fuel prices would justify a slight reduction in the standard offer rate, albeit for a relatively short period of time.

Based on the above information, if price stability is the objective, then a prudent course of action may be to defer any action on the standard offer price at this time and continue to monitor the fuel markets and their effect on the underlying cost to serve the standard offer customer base. Another month or so of market information would be helpful in assessing what type of rate effects might occur in 2007 from a price reduction in 2006.

cc: Docket service list