

**STATE OF RHODE ISLAND AND  
PROVIDENCE PLANTATIONS**

**BEFORE THE PUBLIC UTILITIES COMMISSION**

**IN RE: Narragansett Electric (d/b/a National Grid)  
2008 Annual Retail Rate Filing**

**DOCKET No. 3902**

**DIRECT TESTIMONY**

**OF**

**JOHN STUTZ**

**On behalf of:**

**The Rhode Island Division of Public Utilities and Carriers**

**December 7, 2007**

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1 **1. INTRODUCTION AND SUMMARY**

2

3 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND POSITION.**

4 A. My name is John K. Stutz. My business address is the Tellus Institute (Tellus), 11  
5 Arlington Street, Boston, Massachusetts 02116-3411. I am a vice president at  
6 Tellus.

7

8 **Q. HAVE YOU PREPARED A SUMMARY OF YOUR EDUCATION,  
9 EMPLOYMENT AND PROFESSIONAL QUALIFICATIONS?**

10 A. Yes, it is provided in Exhibit JS-1.

11

12 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

13 A. The purpose is to respond to the 2008 Annual Retail Rate Filing made by the  
14 Narragansett Electric Company (the Company) on November 16, 2007.

15

16 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

17 A. The remainder of this section provides a summary of my key points and  
18 recommendations. My detailed testimony is presented in the following section.

19

20 **Q. WHAT ARE THE KEY POINTS OF YOUR TESTIMONY?**

21 A. My key points are the following:

- 22 • The Company's rate for Standard Offer Service (SOS) is based  
23 directly on estimated costs. Adverse economic developments  
24 could cause actual costs to be less than the estimates. However,

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rising oil prices could make them higher.

- There continue to be very significant increases in transmission-related expenses. These are due primarily to decisions made by ISO-NE.
- Volatility in SOS rates after 2009 is a reasonable concern. However, offers by unregulated suppliers suggest that this problem can be avoided.

**Q. WHAT ARE YOUR RECOMMENDATIONS?**

A. The SOS rate for 2008 should be set at 9.2 cents per kWh as the Company proposes. Consideration for adjusting the rate should occur if the projected over- or under-recovery balance for December 31, 2008 as reported in the filed monthly reconciliation reports, substantially exceeds \$25 million. All of the Company's other proposals should be adopted. In light of the transmission cost increases, the Commission and Company should take what actions they can to ensure that the decisions at ISO-NE which drive the increases give due weight to cost. Finally, to provide the time required to address important but difficult issues such as price volatility, discussion of future SOS arrangements should begin before the Company's March 2009 filing.

## 2. DETAILED TESTIMONY

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**Q. PLEASE BRIEFLY DESCRIBE THE COMPANY'S PROPOSALS.**

A. The Company has proposed three changes in its current rates:

- an SOS rate increase from 8.3 to 9.2 cents per kWh;
- a reduction in the transition charge from 0.559 to 0.322 cents per kWh; and
- an increase in transmission charges that, on average, raises transmission rates by 0.067 cents per kWh.

In total, the Company proposals would produce an increase of \$3.80 for a residential customer on Rate A-16 using 500 kWh per month. The Company also proposes to implement the third phase of the \$2 million low-income annual credit.

**Q. DO YOU SUPPORT THE COMPANY'S PROPOSALS?**

A. Yes, I support all of the proposals and urge their adoption.

**Q. WHAT ISSUES WILL YOU ADDRESS IN YOUR TESTIMONY?**

A. I will address the proposed SOS rate and the increase in transmission costs. I will also briefly discuss future (i.e., post-2009) SOS arrangements.

**Q. HOW WAS THE COMPANY'S PROPOSED SOS RATE DEVELOPED?**

A. The SOS Rate was developed based on an estimate of the cost of the electricity to be obtained in 2008 under the Standard Offer supplier contracts. That cost reflects a **Base Charge** and a **Fuel Index Adjustment (FIA)** developed using publicly

1 available gas and oil price indices. Based on oil and gas price data reported on  
2 October 25, 26, and 29 of 2007, the Company has proposed a rate of 9.2 cents per  
3 kWh for 2008. This is roughly 11 percent higher than the current rate of 8.3 cents  
4 per kWh.

5  
6 **Q. DO YOU HAVE ANY COMMENTS ON THE COMPANY'S PROPOSAL?**

7 A. Yes, I do. As shown in Ms. Lloyd's Schedule JAL-3, the proposed rate is quite  
8 close to the estimated cost for 2008, 9.28 cents. The cost for SOS supply,  
9 particularly the FIA, can be quite volatile. As shown in Exhibit JS-2, the change in  
10 the estimated cost between the Company's filing last year and this year's filing is  
11 1.38 cents, roughly 16 percent. Of that, the change in the FAI was 1.07 cents, a  
12 change of over 50 percent.

13 I would also point out that the Company's proposed increase is driven  
14 primarily by developments that occur in the second half of 2008. In the first  
15 column of Exhibit JS-3, I show the Company's rate calculation, based on data for  
16 all of 2008. The proposed 9.2 cent rate produces an under-recovery of roughly  
17 \$5.3 million. In the second column I show a similar calculation using data through  
18 June 2008 and the current rate of 8.3 cents. The resulting under-recovery is only  
19 about \$2.9 million. In the fuel markets a good deal can change in 6 months.

20 These two points focus attention on the issue of uncertainty in the  
21 estimates of costs upon which the Company's proposed SOS rate rests.

22  
23 **Q. DO YOU SUPPORT THE COMPANY'S SOS RATE PROPOSAL?**

1 A. Yes, I do. However, I am also aware that SOS supply costs could easily be above  
2 or below the estimate on which the Company's proposal is based. To deal with  
3 this uncertainty, I recommend that the Commission review the monthly reports  
4 made by the Company carefully. If under- or over-recovery moves substantially  
5 beyond the \$25 million range which I testified last year was reasonable, the  
6 Commission should consider adjusting the SOS rate.

7  
8 **Q. WHAT ARE THE UNCERTAINTIES THAT AFFECT THE SOS SUPPLY**  
9 **COST?**

10 A. The primary uncertainties are related to oil and the economy. Oil prices have risen  
11 dramatically and then declined somewhat. With OPEC's recent decision not to  
12 raise production there may be another round of increases. On the other hand,  
13 anticipated adverse economic developments create a real possibility of lower costs  
14 in 2008.

15  
16 **Q. HOW MIGHT ECONOMIC DEVELOPMENTS AFFECT SOS SUPPLY**  
17 **COSTS?**

18 A. Recently the prospects for the economy have worsened. There is general  
19 agreement now that there will be at least a slowdown, and possibly a recession,  
20 that is a decline in growth lasting at least half a year. Adverse economic  
21 developments affect the demand for oil and gas, and so their prices, in two  
22 separate ways. First, a lower level of economic activity means that, all else equal,  
23 there is less need for oil and gas. Second, economic developments such as the

1 decline in housing prices, have a “wealth effect,” that is they make consumers less  
2 willing and able to spend, on gas and oil, and on other things as well

3 The Company estimates that the FIA will increase rather dramatically  
4 between 2007 and 2008. Whether the Index actually rises as estimated will depend  
5 on future prices of oil and gas which, in turn, will depend in part on the state of  
6 the economy. With a slowdown or recession, the currently anticipated growth in  
7 fuel prices and so in SOS costs shown in the current estimates, may not occur.

8

9 **Q. LAST YEAR YOU SUPPORTED AN SOS RATE THAT WAS SET ABOVE**  
10 **THE ESTIMATED COST OF SUPPLY. WHY NOT SET THIS YEAR’S**  
11 **RATE IN THE SAME WAY?**

12 A. The situation is significantly different this year. This year setting the rate above  
13 (or below) cost raises issues of rate stability.

14

15 **Q. PLEASE EXPLAIN THESE ISSUES.**

16 A. Bonbright’s *Criteria of a Sound Rate Structure* reproduced as Exhibit JS-4,  
17 include as Criterion No. 5 the following:

18 5. Stability of the rates themselves, with minimum of unexpected  
19 changes seriously adverse to existing customers. (Compare “The  
20 best tax is an old tax.”)

21 Customers generally perceive rate increases as “seriously adverse” to their  
22 interests. This perception will be enhanced by the slowdown or recession  
23 anticipated for 2008. Since SOS rates have been stable or falling since January

1 2006, any increase is likely to be “unexpected.” Thus, setting the rate above cost  
2 is not consistent with rate stability.

3           Setting the 2008 SOS rate below cost also raises issues of rate stability  
4 because it could result in a deferral. Recovery of this deferral would add to any  
5 increase required in 2009 to pay for the scheduled .4 cent increase in base costs, to  
6 cover any further increase in the FIA or to cover other costs such as those  
7 associated with the claim referred to in Commission Data Request 1-6.

8           The appropriate choice for 2008 is to set the rate at the estimated cost as  
9 the Company has done.

10

11 **Q. TURNING TO YOUR SECOND ISSUE, PLEASE BRIEFLY DISCUSS**  
12 **THE TRANSMISSION COSTS THAT THE COMPANY PROPOSES TO**  
13 **RECOVER.**

14 A. The costs that the Company proposes to recover are shown in Ms. Haines’  
15 Schedule MPH-1. As indicated there, the costs are divided into NEP local  
16 charges, ISO charges for Pool Transmission Facilities and specific services, and  
17 ISO/RTO administrative charges. The Company has included tables similar to  
18 Schedule MPH-1 in its filings since at least 2001. Exhibit JS-5 provides a  
19 compilation of the Company’s cost estimates for 2002 to 2008 based on these  
20 submissions. As the data in the exhibit show, costs were roughly stable from 2002  
21 to 2005. However, over the last four years, they have grown rapidly.

22

23 **Q. DO YOU HAVE ANY COMMENTS RELATED TO THE INCREASE IN**  
24 **TRANSMISSION COSTS?**

1 A. Yes, I do. Because the broad categories used in Exhibit JS-5 include increases as  
2 well as decreases, they do not pinpoint the primary source of this year's increase.  
3 It is ISO-approved investments that drive the increase. Narragansett expects an  
4 increase of \$10.4 million in transmission expenses. Of this amount, \$9.7 million  
5 is due to this additional transmission plant investment which is forecast to go "in-  
6 service" in 2008 across New England. The projects driving this \$9.7 million  
7 increase are shown in Schedule MPH-7. Their capital cost totals a bit over \$1  
8 billion!

9 An administrative body such as ISO-NE is not likely to have the same  
10 sensitivity to costs as state-level regulators and local utilities. Thus, in exercising  
11 its judgment, ISO-NE may make choices that, on balance, inappropriately increase  
12 costs. This point is made very forcefully in a letter sent to Senator Snowe by the  
13 General Manager/CEO of the Pascoag Utility District. The letter refers to "the  
14 "absence of cost considerations in ISO decision making." (For convenience, the  
15 letter is reproduced as Exhibit JS-6.)

16  
17 **Q. WHAT ACTION DO YOU RECOMMEND?**

18 A. In light of the \$1 billion increase in transmission investment and the associated  
19 \$9.7 million in costs for the Company, it would be appropriate for all parties to do  
20 what they can to make it clear to ISO-NE that they are deeply concerned about the  
21 cost increases arising from its decisions concerning transmission investment.

22  
23 **Q. MOVING TO YOUR THIRD ISSUE, PLEASE EXPLAIN YOUR**  
24 **CONCERNS ABOUT FUTURE SOS ARRANGEMENTS.**

1 A. The letter to Senator Snowe raises various issues about the electric power markets  
2 in New England. Most are likely to be controversial. However, one issue that is  
3 not controversial is the volatility of the prices those markets produce. Consider for  
4 example, the price of Last Resort Service which Mr. Hager characterizes as a  
5 “market cost proxy” for SOS. During 2007, when the SOS rate was a constant 8.3  
6 cents per kWh, monthly Last Resort rates varied from a high of 13.189 cents per  
7 kWh to a low of 8.344 cents , a range of nearly 60 percent.

8

9 **Q. IS IT POSSIBLE TO PROVIDE SERVICE TODAY AT NON-VOLATILE**  
10 **RATES?**

11 A. Yes, that appears to be possible. In fact, suppliers such as Direct Energy offer it.  
12 Under “Price Protection Plans,” the Direct Energy web site provides the following  
13 offer:

14 “With the volatility in electricity prices over the last few years,  
15 Direct Energy has created fixed rate programs to help you protect  
16 your business from uncertainty. No tiered pricing. No rate  
17 adjustments. No added stress. Direct Energy can help you lock in  
18 your price today, for the next five years, and help you put your  
19 money back into your business.”

20 Direct Energy also offers price protection to residential customers on its web site:

21 “As one of the largest integrated retailers in North America, we  
22 have the ability to protect what you pay for electricity. So you  
23 don’t have to worry about the volatility of energy prices.”

24

1 **Q. SHOULD SERIOUS DISCUSSION OF SOS SERVICE AFTER 2009 WAIT**  
2 **UNTIL THE COMPANY'S FILING IN MARCH OF 2009?**

3 A. No. How best to provide future SOS at stable, reasonable prices is a difficult  
4 issue. Dealing with issues such as volatility will probably require a substantial  
5 amount of discussion. To ensure that the best arrangements for future SOS service  
6 are developed and put forward, discussion should begin before the March 2009  
7 filing. If discussion does not lead to a consensus proposal, parties other than  
8 Narragansett should be permitted to file proposals or comments in March 2009.

9

10 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

11 A. Yes, it does.

## BACKGROUND AND QUALIFICATIONS

### Education and Employment

Dr. Stutz received a B.S. from the State University of New York at Stonybrook in 1965 and a Ph.D. from Princeton University in 1969. Both degrees are in mathematics. After completing his Ph.D., he taught and did research at the Massachusetts Institute of Technology, the State University of New York at Albany where he received tenure, and Fordham University. At Fordham he held the position of associate professor of mathematics and was co-director of the program in mathematics and economics. He left Fordham to help found Tellus where he has been employed since 1976.

Tellus is a non-profit organization. It provides research and consulting services primarily to clients in the public sector, in the areas of energy, environmental policy, solid waste management, water resource planning, and sustainable development.

### Professional Qualifications

Dr. Stutz has extensive experience in the utility industry. Since 1977 he has appeared as an expert witness before the Federal Energy Regulatory Commission (FERC), Public Utility Commissions in 39 states and the District of Columbia, and three provinces in Canada. In total, he has appeared in 200 proceedings as shown in the attached table. Most of his appearances have been in electric utility proceedings. However, he has also testified on gas and telecommunications matters. Much of Dr. Stutz's testimony has addressed ratemaking issues. Since 1979, he has appeared as a witness on ratemaking in 141 proceedings. His testimony has addressed a variety of topics, including marginal costs, embedded cost-of-service studies (COSS), service quality standards, and numerous aspects of rate design. Since the early 1980s Dr. Stutz has testified regularly on behalf of the Staff of the Rhode Island Division of Public Utilities and Carriers. Since the mid 1990s he has also testified regularly on behalf of the Staff of the Nova Scotia Utility and Review Board.

Dr. Stutz's articles and comments on utility-related subjects have appeared in the *Public Utilities Fortnightly*, *The Electricity Journal*, and other journals. His paper with Thomas Austin is cited, in the second edition of Bonbright's *Principles of Public Utility Rates*, as a source of information on electric ratemaking in general and COSS in particular. He was the lead author of *Aligning Rate Design Policies with Integrated Resource Planning*, a report commissioned and published by the National Association of Regulatory Utility Commissioners (NARUC). As NARUC's preface states, Tellus was selected to prepare this report largely because of Dr. Stutz's expertise. Dr. Stutz has been an invited speaker at NARUC, CAMPUT, and other utility conferences.

In addition to his utility-related activities, Dr. Stutz has worked for the United States Environmental Protection Agency (EPA), the Organisation for Economic Cooperation and Development (OECD), and various state and local agencies, on issues related to solid waste management and its impact on the environment. Over the past 4 years he has also worked extensively on issues related to well-being and sustainability.

**Dr. Stutz's Testimony Before Regulatory Commissions**

STATE	APPEARANCES		STATE	APPEARANCES	
	<u>Ratemaking</u>	<u>Planning</u>		<u>Ratemaking</u>	<u>Planning</u>
Alabama	1		Minnesota	2	
Arizona	5		Mississippi	1	
Arkansas	1		Nevada	4	3
Canada	16		New Jersey	8	
Colorado	6	4	New York		5
Connecticut	3	3	New Mexico	6	
Delaware	3		New Hampshire	2	
District of Columbia	1		North Carolina	3	
FERC		3	Ohio	5	1
Florida	1	3	Oregon	1	
Georgia		1	Pennsylvania	2	4
Hawaii		1	Rhode Island	29	3
Illinois	1	3	South Carolina	1	
Iowa	1		Tennessee	1	
Kansas	1		Texas	7	1
Kentucky	1		Utah	2	
Louisiana	2		Vermont	3	1
Maine	11	5	Virginia	1	
Maryland	2		Washington		1
Massachusetts	1	5	West Virginia	3	
Michigan	2	12	Wisconsin	1	
				<u>Total</u>	<u>Total</u>
				<u>Ratemaking</u>	<u>Planning</u>
				141	59

**SOS COST COMPARISON**  
(¢ per kWh)

	-----Filing-----		Difference
	Last Year	Current	
Base Charge	6.30	6.70	.40
Over-Recovery	(.44)	(.53)	(.09)
Fuel Index Adjustment	2.04	3.11	1.07
Total	7.90	9.28	1.38

**SOS RATE DESIGN**

	<b>Company Proposal</b>	<b>1<sup>st</sup> Half Year Data</b>
2008 Expenses (\$ Million)	644.1	299.9
2007 Over-Recovery (\$Million)	(34.9)	(34.9)
Net Cost (\$ Million)	609.2	265.0
Usage (Million kWh)	6,565.6	3,158.4
Rate (¢ per kWh)	9.2	8.3
Under-Recovery (\$ Million)	5.3	2.9

### CRITERIA OF A SOUND RATE STRUCTURE

1. The related, "practical" attributes of simplicity, understandability, public acceptability, and feasibility of application.
2. Freedom from controversies as to proper interpretation.
3. Effectiveness in yielding total revenue requirements under the fair-return standard.
4. Revenue stability from year to year.
5. Stability of the rates themselves, with minimum of unexpected changes seriously adverse to existing customers. (Compare "The best tax is an old tax.")
6. Fairness of the specific rates in the appointment of total costs of service among the different customers.
7. Avoidance of "undue discrimination" in rate relationships.
8. Efficiency of the rate classes and rate blocks in discouraging wasteful use of service while promoting all justified types and amounts of use:
  - (a) in the control of the total amounts of service supplied by the company;
  - (b) in the control of the relative uses of alternative types of service (on-peak versus off-peak electricity, Pullman travel versus coach travel, single-party telephone service versus service from a multi-party line, etc.).

Source: James Bonbright, *Principles of Public Utility Rates*, Columbia University Press, 1961, page 291.

**ESTIMATES OF ANNUAL TRANSMISSION EXPENSES**  
**(\$ Million)**

<b>Year</b>	<b>NEP Local Charges</b>	<b>Regional ISO-NE Charges</b>	<b>ISO/RTO Administrative Charges</b>	<b>Total</b>
2002	11.6	29.5	1.6	42.8
2003	11.8	25.2	1.5	38.6
2004	11.9	24.7	2.1	38.7
2005	13.9	28.3	2.1	44.2
2006	14.7	36.3	1.8	52.8
2007	16.0	44.1	1.4	61.6
2008	19.1	51.3	1.6	72.0

**LETTER TO SENATOR SNOW FROM PASCOAG UTILITY DISTRICT**

November 15, 2007

The Honorable Olympia Snowe  
154 Russell Senate Office Building  
Washington, DC 20510

Dear Senator Snowe:

I am writing, on behalf of the Pascoag Utility District, Rhode Island's only not-for-profit Public Power Utility, to express our support and appreciation for your leadership on the important subject of cost accountability in our nation's unregulated electric markets. Your sponsorship of the "Consumer Protection and Cost Accountability Act" is a vital first step in the actions that my utility, as well as many others, have been seeking in order to put the interests of electric consumers back into the dynamics of competitive wholesale electric markets. This bill, in our opinion, would impose modest but fundamental requirements on the Federal Energy Regulatory Commission (FERC) to assure that independent system operators, such as ISO New England, accomplish their mission of reliable electric service and competitive power markets consistent with the "*lowest reasonable cost*" to consumers.

The Pascoag Utility District is a member of NEPPA an organization that represents over 79 electric light companies throughout New England that are owned and operated by the communities they serve. Our members are governed by elected or appointed officials who represent the interests of our customers, and have brought low-cost, reliable electric service to our customers for well over 100 years.

We feel strongly that consumers have not been well served by deregulation in New England. In the years that have passed since the formation of ISO-New England, retail prices have climbed steadily, driven by high natural gas prices, significant profit-taking in wholesale energy markets, and ISO-required payments to private generators in order to transition the region to new, untested, auction-based power markets. Going forward, the ISO itself projects no significant changes in price trends.

The absence of cost considerations in ISO decision-making is a fundamental flaw in the New England approach to competitive power markets. By not subjecting reliability and market rules to a cost test, the resulting decisions will always be more expensive than they would otherwise be. While we believe that ISO-New England is an organization of talented professionals who work hard to carry out their mission, we also believe that their mission is lacking an essential element for any organization that serves the public interest. No company and no public agency can survive without understanding that customers are the final decision-maker.

As a consumer-owned electric utility company, PUD ratepayers have experienced, first hand, the impact of rising power costs in communities throughout our region. Due to the restructuring of the electric utility industry in most New England states, NEPPA members, such as us, often represent the only voice of consumers in regional discussions and negotiations with other "market participants." We truly understand the importance of the legislation which you are sponsoring.

Again, we strongly support this bill and look forward to working closely with you and your colleagues to see that it becomes law.

Very truly yours,

---

Theodore G. Garille  
General Manager/CEO